Economic Integration and Interdependence in Central and Eastern Europe

Edited by
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Dialóg Campus

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Vákát oldal

ECONOMIC INTEGRATION AND INTERDEPENDENCE IN CENTRAL AND EASTERN EUROPE

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Zoltán Felméry

The present comparative volume reviews the processes and results of economic integration as well as patterns of interdependence in case of seven Central and Eastern European (CEE) countries between 1989 and 2016 from the perspectives of the following countries: Austria, Croatia, the Czech Republic, Hungary, Poland, Romania and Slovakia. The authors of the volume present country-specific experiences resulted from economic integration and interdependence. Furthermore, based on these experiences, this comparative volume tries to identify the similarities and differences in paths followed by these countries and their impact on economic convergence. If we take a look at some of the important economic characteristics of these countries, it can be stated that the overall economic picture is entirely heterogeneous (Table 1).

Table 1.

Some important economic characteristics of the examined countries

Economic characteristics	**A**	**HR**	**CZ**	**H**	**PL**	**RO**	**SK**
GDP per capita PPP (USD)	44,144	21,409	31,072	25,381	26,003	21,648	29,156
GDP annual growth rate (%)	2.6	2.8	4.7	3.2	3.9	5.9	3.3
Government debt to GDP (%)	84.6	84.2	36.8	74.1	54.1	37.6	51.9
Private debt to GDP (%)	166.0	N/A	136.0	140.0	127.0	N/A	121.0
Unemployment rate (%)	7.9	10.8	3.8	4.1	6.8	5.0	6.4
Youth unemployment rate (%)	9.6	25.0	7.5	11.0	13.8	16.8	14.9
Inflation rate (%)	2.4	1.4	2.7	2.5	2.1	1.8	1.6
Interest rate (%)	0.0	2.5	0.5	0.9	1.5	1.75	0.0
Minimum wage (EUR/ month)	–	433	407	412	453	275	435
Productivity (Index points)	104	102	110	101	115	121	113

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Economic characteristics	A	HR	CZ	H	PL	RO	SK
Current account to GDP (%)	1.7	2.6	1.1	4.8	–0.3	–2.3	–0.7
Budget balance to GDP (%)	–1.6	–0.8	0.7	–1.7	–2.5	–3.0	–1.7
Government spending to GDP (%)	51.1	48.4	39.9	47.5	41.3	34.7	41.6
Competitiveness rank	18	74	31	60	39	68	59
Ease of doing business rank	22	51	30	48	27	45	39

Note: The data of the table were collected on 7 November 2017. The frequency of the illustrated data in most of the cases is a year, but there are some data that are published quarterly (GDP per capita; GDP annual growth rate, minimum wage, productivity, balance on current account to GDP), monthly (unemployment rate, youth unemployment rate, inflation rate) or even daily (interest rate).

Source: Trading Economics s. a.a; Trading Economics s. a.b

Therefore, independently of the close geographic location of these countries and their common ambition for economic convergence to the core countries of the European Union, we should be careful with general statements on economic development. Some countries examined by us are indeed similar even along several economic indicators, but differences are significant along other indices. We may think that there are fundamental economic similarities between countries of the Central and Eastern European region—and this statement from a remote perspective to a certain extent is true—but on closer inspection, there are substantial differences.

Between the awareness of current differences, it is worth noticing that there are common motives in economically approaching the average development of the European Union. The implementation of the approaching process naturally reduces regional differences and that leads us to the conceptual starting point of our comparative volume. The institutions of political integration in Europe have been founded upon the mutual benefits of economic cooperation and modernisation, also inherently resulting in growing interdependencies. The success of economic cooperation is an essential pillar of sustained motives for integration. However, CEE countries have approached and entered economic integration from different starting points and positions: some were in a more beneficial position, some in less beneficial. The openness, productivity, level of modernisation, competitiveness of CEE economies—usually in a much weaker position in the 1990s than the Western European "economic core"—have also been moving on different paths of growth and modernisation within the new frameworks of economic

integration. Understanding the dynamics behind these processes and drawing the conclusions of the successes and failures of economic integration is key to steer national and regional economic policies on a convergent path if the economic (and political) institutions of integration are to prevail among the various challenges of the 21st century.

Based on the above-mentioned starting point, the research questions of the comparative volume are the following. What is the experience of CEE countries regarding economic integration and interdependence in the period 1989–2016, what drivers have been effective and what fields can be identified as successful and unsuccessful? To what extent have CEE countries benefitted from closer economic integration and interdependence, and what have been the risks and costs related to these? Looking back on the past two and a half decades, could these countries be on a path of economic growth, modernisation and prosperity—and if yes, to what extent can it be attributed to the membership and cooperation with the European Union?

Reading this volume, we are awaiting answers to the above research questions. To fulfil this objective, the volume—ignoring these introductory methodological ideas—contains seven chapters. These chapters are country-specific reports analysing economic integration and interdependence processes and characteristics of the examined countries. The authors of these chapters are local experts of CEE countries who deal with the economic policy of these countries and/or integration studies, selected through a competitive process. Each chapter follows the following structure, each country-specific report examines the following phenomena. The volume attaches particular importance to the examination of *conditions at the beginning of the integration process.* Providing fundamental statistical data (i.e. GDP, GPD/capita, Human Development Index, etc.) the authors illustrate what kind of economic and social conditions had these countries before the start of economic integration. Without getting acquainted with the starting points, the "covered distance" of the single countries cannot be evaluated either. Therefore, they review the circumstances, the main challenges and the expectations at the beginning of the Europeanisation process and try to analyse how these early expectations could come true since that time. We can lay down that all of these countries have taken numerous challenges to integrate their national economy into the regional and the EU market by aligning their structural reforms with the EU acquis. The authors describe the nature of changes—from shock therapy to incremental steps—these countries implemented to leave behind planned- and build market economies.

They describe the extremely difficult process of simultaneously outstepping the legacy of Socialism and accomplishing the drastic European accession criteria. The path from a one-party state and a centralised economy to a democratic system based on the rule of law and a market economy now seems to be a clear decision, but that time it was not. The authors outline and make comparable the different development paths of transformation and modernisation and based on these, they evaluate the implemented steps of economic integration.

Additionally, the volume examines the *interdependence and economic penetration* of the above countries. Within this framework, the authors present the changes in the main fields and directions of economic activities and cooperation since 1989. They present the leading import/export commercial partners and the changes in the import/export portfolio of these countries towards EU members or other partners. The authors analyse the embeddedness in regional and global value chains and the evolution of the balance of trade and its impact on economic performance and further economic integration. In addition, capital flows, foreign direct investment patterns and investment trends are also illustrated in the volume. The authors examine the statement that political and economic integration has resulted in a spectacular increase in trade and investment. The main reasons behind Foreign Direct Investments (FDI) inflows and the effect of the FDI-based, export-driven model typical to the majority of the countries in the region will be also scrutinised. Not only the advantages of this model manifested in long-term GDP growth, falling unemployment and positive balance of trade, but also the disadvantages manifested in a negative net investment position, negative balance of primary income and an extremely high degree of export dependence will be taken into account. If foreign direct investment indeed played an important role in promoting structural changes and the increase of labour productivity, the authors attempt to identify the main investors and the relationship between foreign investments and the accession to the European Community. The country-specific reports also contain the analysis of investment trends by economic sectors. The authors examine the development of investments allocated in the various sectors of the national economy in this period. The volume equally deals with the assessment of the ownership structure in strategic sectors of the economy (i.e. agriculture, banking, energy sector, food industry, infrastructure, etc.). In this context, the authors examine that as a result of closer cooperation/integration with the EU what kinds of changes have occurred in the ownership structure. Trends in the proportion

of "international/domestic ownership" and the presence of foreign companies are presented in the volume. However, besides presenting the number of foreign companies, we find it more important to evaluate their economic utility to national economies and their economic leverage. The extent of profits and funds withdrawn from these countries by foreign actors (investors, firms, multinational companies) is also an element worth exploring. In most cases, the authors of the country-specific reports pay close attention to assessing the relationship between the analysed country and the Eurozone. Economic experiences, effects in terms of interdependence, advantages and vulnerabilities (i.e. reflecting upon the economic crisis starting in 2008–2009) occurred after the accession are fundamentally analysed in case of countries that have already joined to the Eurozone. In case of countries that have not yet joined, the authors primarily focus on the reasons for absence. Also, the motivation for a potential future accession and the fulfilment of Maastricht macroeconomic criteria is a subject of our examination. The authors also pay particular attention to the evaluation of the necessary austerity measures and social tensions occurred by the financial and economic crises from the perspective of being a member of the Eurozone or not. In the reports, the authors test the statement according to which membership of the Eurozone has contributed decisively to the fiscal and financial stability of a country during and after the crises. The volume also examines how the financial crisis influenced the aspirations of further economic integration. The authors seek the answers to the following questions. Has the support of integration on the part of these countries eventually changed or not? Is the demand for intensifying the integration still on the agenda or not? Were the crises considered a consequence of economic integration and the lack of independent decision-making skills by CEE societies or quite the contrary, the recovery from the crises was due to the widespread integration? In addition, the volume reviews the most important economic advantages that these countries can offer to investors and companies and how these fundamental economic skills evolved both towards and after EU accession. In case of each country, the most important economic characteristics are identified (i.e. favourable taxation, skilled and/or cheap labour force, good infrastructure, innovative environment, etc.) that were driving forces of a country's competitiveness and could have contributed to economic convergence in the past two decades.

The economic convergence process of these countries is fundamentally based on funds made available by the European Union. The examined countries are the major beneficiaries of EU structural funds. Therefore,

the availability and the use of EU funds are carefully being scrutinised by the authors of the volume. The structural and/or the development funds these countries received from the EU since the 1990s are equally reviewed and analysed from the perspective of their effect on economic and social development. We would like to know what kind of impact these sources have on the economic and social development of the CEE countries. Did they really contribute to the increase of the standard of living and lowered the developmental gap between the region and the more developed EU members? The authors also provide a close examination of the situation of how these funds have been used. Not only the transparency of the use of these resources but the destinations are primarily set to focus. The authors of the volume demonstrate the ratios that are spent in each country on the development of the infrastructure or innovation and job creation. It is clearly detailed in the volume in which sectors, at what absorption ratio are EU funds present in these countries and how much economic growth is due to these resources. The authors draw a suggestive and hypothetical picture to us about how economic growth and investment rate would have developed without the funds of the European Union.

The *socioeconomic effects of integration and interdependence* cannot be ignored, as well. In the volume, not only the purely economic effects but also the socioeconomic effects of integration play a prominent role during the analysis. By reading the country-specific reports, we can receive information about the social costs of the transformation process and the beneficial and disadvantaged economic and social consequences of the "four freedoms" resulted from the integration. Examples can be found in both cases. On the one hand, as a result of the free movement of people, these countries in general experience the outflow of educated and skilled workforce. Due to the so-called brain-drain or skill-drain processes, most of the examined countries face currently serious labour market and other difficulties. Furthermore, the rapid economic transformation occurred simultaneously with the integration process eventuated in growing territorial differences, increased level of poverty or a shrinking number of middle-class members. On the other hand, the citizens' access to the whole labour market and the extent of remittances transferred home by the emigrant workforce slightly add colour to diversity through the fact that these remittances in some countries are relevant at the level of the whole national economy. In terms of the socioeconomic effects of integration, there are common statements; at the same time, it must be said that the examined countries can be characterised by large differences.

Also, the analysis of the socioeconomic effects of integration in addition to the examination of the purely economic aspects makes our review more balanced and realistic even on the level of the single countries.

All country-specific reports have *a conclusion and an outlook.* This part of the reports draws the balance of the results of integration. The authors try to take a position on whether integration has been successful or not and they try to summarise the primary reasons of success and failure. Evaluating the integration successfully is based on several criteria. The authors review the process of integration in terms of how much it supported the structural reforms and fiscal consolidation of the single countries. Moreover, they try to evaluate the fact how much it contributed to the development and modernisation of these countries. In the volume, we ultimately try to understand how these countries managed to achieve the transformation from communism to capitalism and the integration from planned economy into the market economy system of Europe. At the moment of the accession to the European Union there was a public perception that once you get into the "European club", economic and social problems will be quickly solved. Today we are aware of the recognition that things did not happen that way. If the integration was not a total success, the authors also collect the reasons that hindered people in the country to think about how to integrate economically successfully to the European Union. Furthermore, they analyse the reasons of the fact that opinion leaders in the country only now start to think about actions that support them forming the integration in a way that better serves the implementation of national interests. As an outlook, the authors also try to estimate the next steps of the countries towards furthering economic integration or rebalancing interdependence, if desirable. Despite the achievements in integration these countries still have, serious challenges remain to be addressed. It is not a secret that these countries still suffer from bureaucratic burdens, economic obstacles, institutional imbalances, structural inaction and the lack of inclusive and innovative initiatives. Furthermore, there are still shortcomings in economic welfare, social equality and public sector efficiency.

All country-specific reports of the volume analyse the economic transformation process of the examined countries in the period 1989–2016 focusing on integration and interdependence in relation to other European countries. The reports that are based on literature review and the analysis of statistical data, expound the main macroeconomic indicators and trends of the countries in order to provide a comprehensive picture.

13% of Europe's population live in the seven countries analysed in this volume. These seven countries contribute with 7.8% to the nominal GDP produced a year in Europe. Furthermore, the 3.77% average GDP growth rate of the region slightly exceeds the average data of the European countries (3.27%).[1] Therefore, they equally deserve our attention than other countries on the continent. Especially in the light of the interpretation of some politicians and analysts who consider this region the driving force of Europe in the coming period. The volume does not undertake to comment on the previous conjecture. However, instead of guessing, in this volume the authors evaluate the change of conditions in the last two and a half decades that have established the economic processes of the future.

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[1] The source of data necessary for the calculations that are published in the paragraph: 1. Worldometer (s. a.); 2. Wikipedia (s. a.); 3. Trading Economics (s. a.b). In case of comparisons, the average data of the CEE countries were compared to the average data of the whole European continent and not to the European Union.

Chapter 1.

Economic Integration and Interdependence in Austria

Austria's Road from Neutrality to Deep Integration

Attila Kovács

Introduction

Austria has witnessed a significant reshuffling in its political, economic and social relations in the last 30 years. Three key milestones could be distinguished in this road. First, the fall of the Iron Curtain, the elimination of the division of the European continent. Austria is neighbouring with many countries in the former Soviet bloc, and the political changes in the Central and Eastern European region had immediate implications on the country. Second, Austria's European integration, which means the country's accession to the economic bloc in 1995 as well as joining the Eurozone in 1999. Finally, the Eastern enlargements of the European Union also had many impacts on Austria, its economy, trade relations, labour market and investment portfolio.

The objective of this paper is to give an overview of the economic and social development of Austria since 1989. In this context, special emphasis will be devoted to the implications of the fall of the Iron Curtain, the process of the European integration of Austria as well as the Eastern enlargement of the EU on Austria's trade and Foreign Direct Investments (FDI) relations.

The paper is structured as follows. First, I give a chronological overview of Austria's political and economic relations in the last decades, with the main milestones of this period. Second, we discuss the balance

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of Austria's EU accession. This is followed by a section on the macroeconomic trajectory of the country. In this chapter, the macroeconomic performance and environment of the country will be analysed. Afterwards, the economic integratedness and dependence of Austria are analysed, with special emphasis on FDI, trade, globalisation indices and economic complexity. Finally, the paper concludes.

The Conditions at the Beginning of the Integration Process Historical Overview of the Four Steps for Austria to Open Up

In 1989 the Iron Curtain fell quickly and unexpectedly, ending the separation between Western Europe and the Soviet Union. After 44 years of an almost completely sealed border, trade was suddenly free to reconnect. Despite the political and economic turmoil within the Eastern regimes, trade between West and East almost doubled within five years after 1990. By the year 2000, it had almost tripled. The 44 years of Iron Curtain division severed all formal and business relationships, almost all trade between East and West, and made personal contacts difficult. However, historical legacies and cultural linkages persisted, facilitated by some low-level economic ties during the Cold War. (Beestermöller–Rauch 2018) The breakdown of the communist regimes in Eastern Europe resulted in a major structural break in the international economic relations of most Central European countries. This is particularly the case for Austria. Due to its geographical situation and its strong historical ties, especially with former Czechoslovakia, Hungary and Poland, Austria received disproportionally more immigrants than other countries and its trade flows reacted more strongly. Already in 1989, Austria had the largest export volume to the Central and Eastern European Countries (CEECs) all over Europe, except for Germany and Italy. (Aiginger et al. 1995)

Austria is a highly developed industrial nation with a huge and dynamic services sector. The country's geopolitical position between Western European industrialised nations and the growth markets in Central, Eastern and Southeastern Europe (CESEE) has led to a high degree of economic, social and political integration with the European Union and non-EU countries in CESEE. Border controls between Austria and all of its eight neighbouring countries were lifted under the EU's Schengen Agreement. EU enlargements in 2004 and 2007 strengthened Austria's attractiveness as an investment

location by increasing access to markets in Eastern Europe, but expansion also bolstered Austria's competitors in that region so that, due to their vicinity, Budapest, Prague and Bratislava now compete directly with Vienna for foreign investors. (DoS[1] 2014)

Austria experienced a rapid and smooth economic development after World War II. Before the opening of the borders in 1990, exports were heavily concentrated on the three western neighbour countries. Germany, Switzerland and Italy combined to make up 54% of the exports of goods and 58% of imports in 1988. Trade with overseas countries was relatively low if compared, for example, to Switzerland. The trade volume with socialist countries was high relative to other Western European economies, but very low if compared with pre-war ratios and if evaluated from the perspective of location and neighbourhood. The former Czechoslovakia and Hungary were Austria's 16th and 15th largest export partners in 1988. Before the transition started, the bilateral trade balance was in approximate equilibrium. Austria had a slight surplus with Hungary and a small deficit with Czechoslovakia and Poland. Regarding these three countries, for the total period 1988–1993, Austria's exports rose by 154%, imports by 67%. The export share of the three countries adds up to 8% of Austria's exports in 1993 after 4% in 1988. (Aiginger et al. 1995)

The overall impact of the opening of the borders on the economic development in Austria had been a hotly debated political issue since the start of "Ostöffnung". Many industries and firms were confronted with increasing competition because wages in these countries were between 5% (Poland) and 10% (Hungary) of the comparative Austrian labour costs. (Peneder 1993) These huge wage differentials led to fears of serious detrimental impacts, most strikingly, the loss of jobs in Austria.

Austria has taken part in all integration steps since the opening up of Eastern Europe in 1989, gaining EU membership in 1995 and Economic and Monetary Union (EMU) membership in 1999, and participating as an EU member in the EU enlargements since 2004. Four steps of Austria's deep integration into Europe since 1989 can be distinguished as follows. (Breuss 2013)

[1] DoS: Department of State.

Opening up of Eastern Europe in 1989

The opening up of Eastern Europe in 1989 increased the potential of Austria's markets for direct trade and FDI and implied a net inflow of migrants.

EU Membership in 1995

A new EU member must take over the acquis communautaire (Community acquis) of the single market project. This implies communitisation, that is the transfer of competencies, from former national responsibility to EU competence in many economic policy areas: the CAP, the Common Commercial Policy (CCP) by entering into the EU customs union, the common competition policy, a common regional/structural policy, and many other areas in which economic policy is harmonised at the EU level.

EMU Membership in 1999

Participating in the EMU and thus introducing the euro further deepened economic integration. Prior to EMU membership, the hard currency countries Germany and Austria suffered from international competitiveness insofar as the soft currency countries (in the periphery of the EU) depreciated their currencies against the Deutsche Mark bloc in every case of current account deterioration. Of course, a devaluation race was a permanent menace for the single market. After the introduction of the euro, this was no longer possible and hence the international competitiveness was reversed within the euro area. Germany and Austria gained in the form of real depreciation, whereas the others revaluated and lost competitiveness. In addition to this advantage in the competitiveness of the formerly hard currency countries, a single currency eliminates exchange rate uncertainties, thus stimulating trade and FDI. Above all, the deeper financial integration offered new growth-enhancing stimuli for Austria.

EU Enlargement in 2004/2007

As a member of the EU, Austria also benefited from the major enlargement moves in 2004 and 2007, primarily because this involved mainly former Central and Eastern European countries in Austria's neighbourhood. Two main effects were encountered. With the abolition of border controls, Austria was able to increase its trade potential in addition to the effects already happening as a result of the opening up of Eastern Europe in 1989. Integration of low-income countries into the group of high-income countries in the old EU naturally induced factor movements in both directions: FDI from the West to the East, and labour migration the other way round. To mitigate the negative effects on the labour markets, many old EU member states, including Austria, applied exemption rules from freedom of labour in the form of 7-year transitional arrangements. These transition periods were phased out in the first round of enlargement in 2011 and 2014 for the second round. (Breuss 2016)

The EU enlargement on the Central and Eastern Europe countries was a factor for heightening Austria's attractiveness as a business location, overall exports to Central and Eastern Europe has increased, and exports to neighbouring countries (Hungary, the Czech Republic and Slovakia) even increased 4.5 times. This region was especially in demand by Austrian direct investors, in particular. The degree of economic integration in some sectors even exceeds the figures achieved during the Austro–Hungarian monarchy. EU membership also internationalised Austria, by reducing the impact of Germany as its main trading partner and also eliminated Austria's trade deficit; the euro area takes a leading position as a financing region as well, regarding inward FDI as well as loans and deposits by non-residents. (Charushina 2009) Due to the processes of the opening up of Eastern Europe, EU accession, EMU membership and EU enlargement running in parallel, the integration effects of the different stages partly overlap. Hence, the various integration effects do not simply add up. All in all, the integration stages considered here accelerated the growth in real GDP (and only marginally less real GDP per capita) in Austria, the unemployment rate and the rate of inflation shifted downwards. The ratio of imports to GDP increased altogether more than the export ratio. The entire integration process led to a weaker current account balance, mainly brought about by

EU membership and EMU participation, but partly offset by the opening up of Eastern Europe. The latter factor and EU enlargement improved Austria's opportunities to participate actively in the process of globalisation or "mini-globalisation" with regard to Eastern Europe. (Breuss 2016) In the late 1980s, early 1990s, Austria's economic ties to Central and Eastern European countries have been limited. Austria's outward FDI has improved rather quickly during the period of the opening of the Central and Eastern European economies. For Austria, this period of "globalisation" was characterised by two new and substantial economic developments: the pre-EU accession period and the opening of Eastern European economies. Both of them have enforced Austria's international economic activities considerably. However, the FDI-stock-GDP ratio in 1995 was still relatively low. One of the main reasons for this low degree of internationalisation was Austria's industry structure, especially the prevalence of small and medium-sized enterprises (SMEs). (Altzinger 1998)

As well-known from the theoretical and empirical literature, FDI—like trade patterns—is strongly influenced by the geographical as well as the cultural and historical proximity to countries. (Dunning 1993; Petrakos 1996) All four CEECs are adjacent to Austria. Furthermore, it is not surprising that neither Austria's trade nor investment relations with Poland—although a relatively well developed CEEC—are of any significance. There it appears that in Hungary total capital per investment is the lowest of all CEECs, followed by Slovakia, the Czech Republic and Slovenia. The last two countries show total capital per investment which is much higher than in Hungary and Slovakia although far below the amounts of the affiliates established in the Western OECD countries. We have to keep in mind throughout the further analysis that on average the total capital per investment in the CEECs is far below the average investment in Western OECD countries. This verifies that the opening of Central and Eastern Europe also gave SMEs with weak financial capacities an opportunity for internationalisation.

In absolute numbers, by far the largest share of Austria's FDI in the CEECs has been invested in Hungary. In 1995 the four adjacent countries to Austria (Hungary, the Czech Republic, Slovenia and Slovakia) accounted for 91.1% of Austria's overall FDI in the CEECs. The export and import relations of Austria between 1988 and 1993 are illustrated in Table 1. These regional patterns emphasise the importance of geographical proximity which is entirely in accordance with the theoretical considerations of Dunning (1993). Besides, the regional and sectoral patterns of Austria's FDI in the CEECs

show three important issues: the importance of geographical proximity, the significance of investments in the non-manufacturing sectors and a significant activity of SMEs in this process of internationalisation due to relatively low financial requirements. (Altzinger 1998)

Table 1.
Austria–CEEC trade (Billion ATS)

Country		1988	1989	1990	1991	1992	1993
Czechoslovakia	*Export*	4.7	5.0	8.6	9.2	13.8	15.4
	Import	6.0	6.7	6.4	7.4	11.1	12.3
	Balance	–1.4	–1.7	2.2	1.7	2.7	3.1
Hungary	*Export*	6.8	8.7	10.5	14.5	15.6	16.5
	Import	6.4	7.8	8.7	11.5	12	10.8
	Balance	0.5	0.8	1.7	3.0	3.6	5.7
Poland	*Export*	3.7	5.2	4.4	7.5	7.1	6.4
	Import	4.2	4.4	5.0	5.7	5.0	4.7
	Balance	–0.5	0.9	–0.6	1.8	2.0	1.8
Central Eastern Europe	*Export*	15.2	18.9	23.5	31.2	36.4	38.4
	Import	16.7	18.9	20.2	24.6	28	27.8
	Balance	–1.4	0.0	3.3	6.6	8.4	10.6
For comparison: Switzerland	*Export*	27.6	31.1	32.4	30.6	28.9	29.8
	Import	19.9	21.3	23.7	24.7	23.8	23.1
	Balance	7.7	9.8	8.7	5.9	5.1	6.7

Source: Aiginger et al. 1995

Austria's EU Accession and Its Role in the Country's Integration Process

While in the post-war decades Austria was characterised by a high share of public ownership in industries and banks and extensive market regulation that sheltered businesses from international competition, much of what happened during the past three decades has been intended to create an environment that is attractive to foreign capital and to make native capital more competitive. Subsequent measures have included the liberalisation of trade and capital flows and the reduction of corporate taxes. Many of the changes were facilitated through Austria's accession to the EU in the mid-1990s, which in turn led to a further Europeanisation and internationalisation of the Austrian economy. On the other hand, Austrian capital also profited immensely from the EU's

eastward enlargement. However, while profitability soared as a result of outsourcing and productivity increased, due to the shareholder-value orientation and eastward expansion, unemployment remained high compared to the post-war decades.[2] (Hermann–Flecker 2012) Austrian companies benefit above all from the decline in export costs thanks to European integration, because around 70% of Austrian exports go to EU member countries, and conversely, an equally high share of Austrian imports come from other EU countries. (Mannen 2016) The convenience of the common currency tends to have a positive impact on tourism in Austria as well; in 2015, 84% of all overnight stays by foreigners in Austria were accounted for by citizens of the other 27 EU member countries. (Beer et al. 2017)

As Beer et al. (2017) duly summarises, increased trade can lead to more efficiency and productivity and thus have a positive impact on economic growth. Consumers profit from a greater variety of products and lower prices. Increasing integration facilitates foreign direct investment and production across countries. In a globalised world characterised by a high degree of specialisation, products can no longer be produced exclusively in-country, or profitably sold only within the domestic market. To produce on a cost-effective basis and to remain competitive in terms of price and quality, integration into international production chains is thus just as necessary as access to expanded sales markets.[3] This is especially true for small economies such as Austria's.[4] Participation in the single market and EMU has led to greater competition. One of the most important arguments for the increased competition is that it leads to lower prices and thus greater purchasing power, greater choice and, via competitive pressure, to increased product innovation, and thus to higher growth as well.[5] Recent empirical research finds evidence of the growth-stimulating impact of competition.[6] Before the EU accession, there was significantly less competition in Austria; there were many monopolies (telecommunications, post, electricity and gas) and tolerated cartels, as well as sector-specific import restrictions (agricultural products). To ensure competition between companies, the EU prevents barriers to competition and the abuse of market dominance, monitors mergers

[2] But low compared to the other EU Member States.
[3] See Amador–di Mauro 2015.
[4] See Kulmer et al. 2015.
[5] See Porter 2000 and Aghion et al. 2001.
[6] For Austria see Böheim 2004.

and introduces measures to liberalise regulated markets. However, these considerations do not necessarily take the demand side sufficiently into account. Surveys show that just under 50% of Austrians think that EU membership brings more advantages than disadvantages; for about 37%, the disadvantages outweigh the advantages. Opinions are divided with regard to the impact of EU membership on employees as well. Migration issues and unemployment are seen as the greatest challenges for the EU. The majority of Austrians favour remaining in the EU, however. Current economic conditions in Austria are characterised by high unemployment and relatively low economic growth. This prompts some people to conclude that this situation is the fault of the EU and the euro ("things used to be better and cheaper"). A balanced discussion of the impact of EU membership, however, must always compare the current situation with a counterfactual world, in the present, without the EU and the euro.

As one of the richest EU Member States, Austria is a net contributor to the Community budget. The cost of EU membership comes also with extensive benefits, though. In addition to the increase in growth and employment as a result of access to the EU single market, funds in the form of regional assistance, for example, flow directly back to Austria. Even the support of other, poorer Member States has an indirect positive impact on Austria since the purchasing power in these countries is increased and more public investments are carried out, which in turn increases sales opportunities for Austrian companies.

The EU membership of Austria yields the following conclusions: Austria's economy and economic policy had to adjust to the regime of the Single Market. This meant the surrender of autonomous economic policymaking to community responsibility in foreign trade policy, agricultural policy, competition law, regional policy, and, through the accession to the Economic and Monetary Union, also in monetary policy. As the fourth richest EU country, Austria is a net contributor of 0.4% of GDP. The Single Market is not yet fully developed in many areas. In the telecommunications and energy sectors, liberalisation has only just begun. EU membership produced welfare effects of about 2% of GDP and allowed higher economic growth of about 0.5% per year. (Breuss 2000)

Regarding Austria's net financial position to the EU, we can see on Figure 1, that Austria is a net contributor country to the EU's budget, having an operating budgetary balance of approximately 0.3% of its GNI.

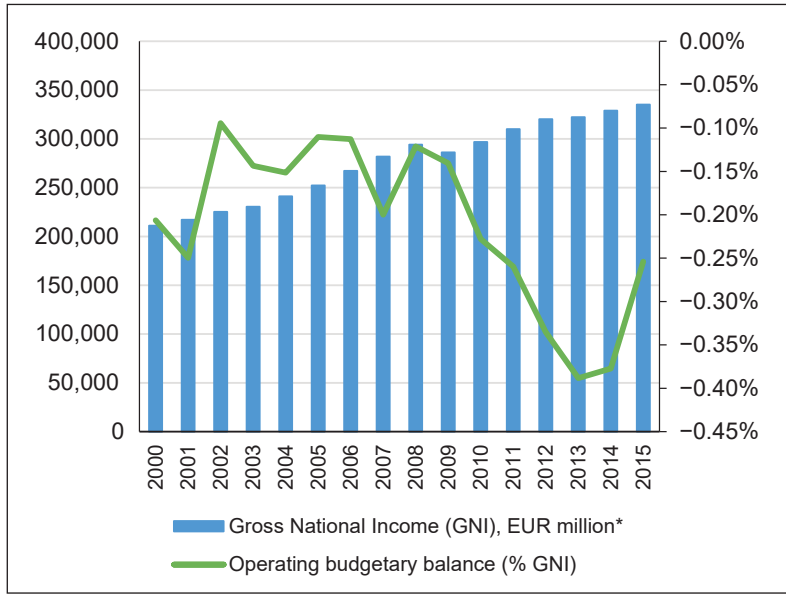

Figure 1.
Austria's net financial position to the EU

Source: EC[7] 2015

The Macroeconomic Trajectory of Austria

In this section of the study, I give a brief overview of the most important macroeconomic tendencies in Austria since the mid-1990s. The level of the central government debt in Austria shows a deteriorating picture in the last 20 years. The level of debt increased by 30 percentage points, from around 70% to more than 100%. The trend fundamentally turned into negative after the crisis of 2008 (Figure 2).

[7] EC: European Commission.

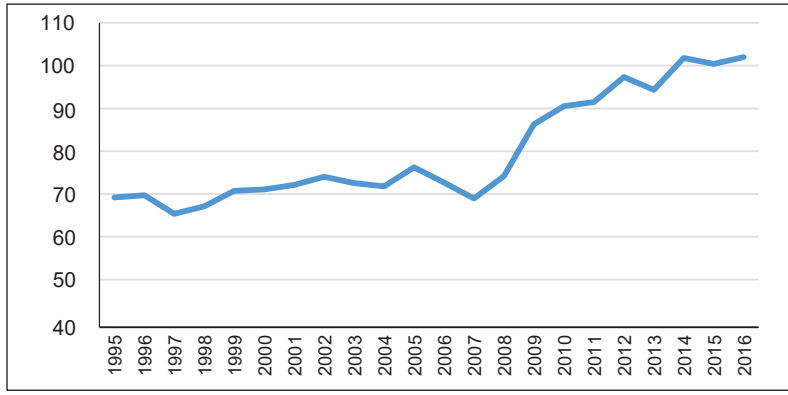

Figure 2.
Central government debt in Austria (% of GDP)
Source: WB[8] 2018a

The current account balance of Austria shows a positive trend in the last two decades. Although very volatile, it increased from some –6% to around –1% (Figure 3). The main reason behind the negative current account balance is the budgetary deficit, which has increased since the 2008 financial crisis.

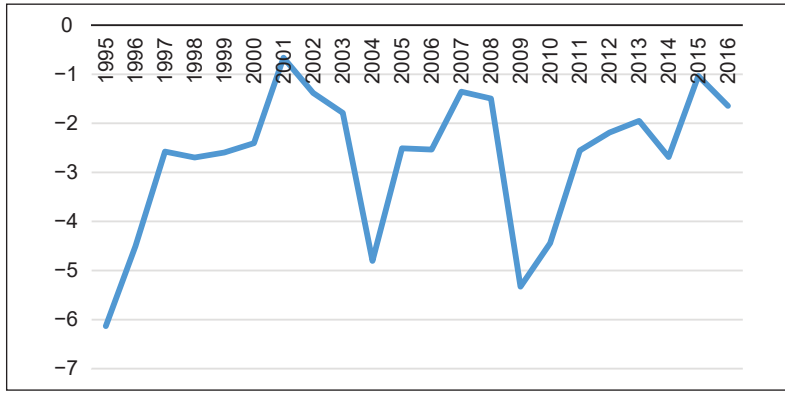

Figure 3.
Current account balance in Austria (% of GDP)
Source: WB 2018a

[8] WB: The World Bank.

Figure 4 shows that the net trade of goods and services in Austria is positive in the last more than one decade. Nevertheless, the tendency is very volatile. We can observe a clearly upward tendency until the 2008 financial crisis, followed by a gradual decline until 2012. The balance in 2016 is somewhat, but very narrowly positive compared to the year 2005.

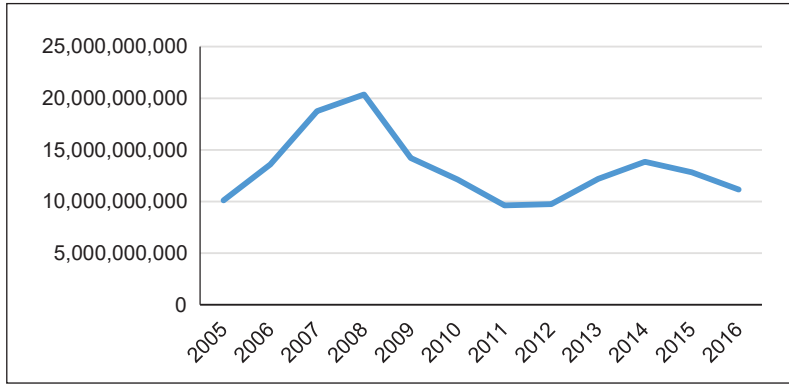

Figure 4.
Net trade in goods and services in Austria (BoP, current USD)
Source: WB 2018a

The United Nations Development Programme's (UNDP) Human Development Index (HDI) expresses the quality of life in light of life expectancy, education and per capita income indicators, which are used to rank countries into four tiers of human development. Austria's Index has steadily grown since the fall of the iron curtain, except a minor fallback in the early 2000s (Figure 5). Today, we definitely consider Austria a welfare state, which is underpinned by the high value of the HDI.

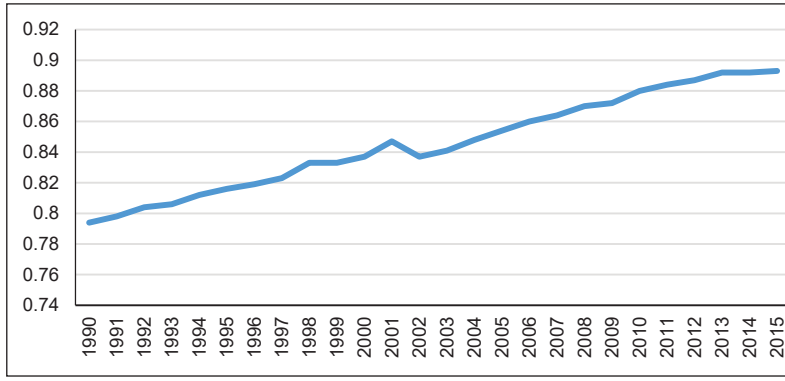

Figure 5.
Human Development Index in Austria

Source: UNDP 2015

The basis for the high quality of life in Austria is the balanced economic development of the country. Figure 6 shows a very volatile tendency of GDP growth in the last 30 years. There is a negative, declining trend behind the annual growth values. It is apparent that after the sharp decline of 2008, the economic growth in the country has not reached the pre-crisis level.

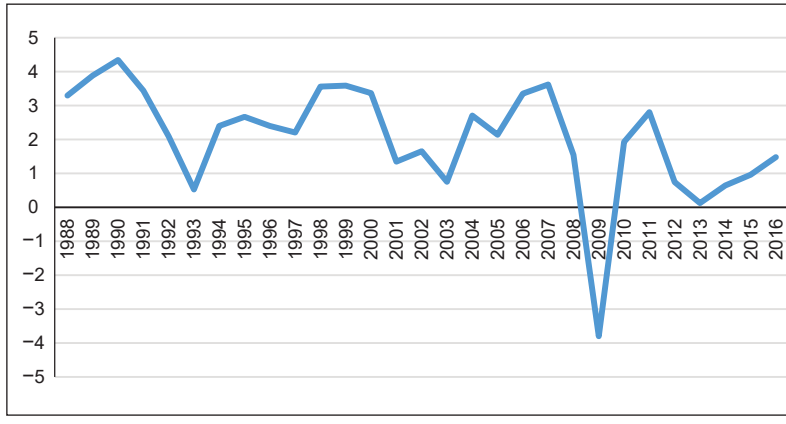

Figure 6.
GDP growth in Austria (annual %)

Source: WB 2018a

In line with the economic performance of the country, GDP per capita has also varied in the last three decades. Nevertheless, the tendency is definitely positive: in this period, per capita GDP in Austria has more than doubled (Figure 7).

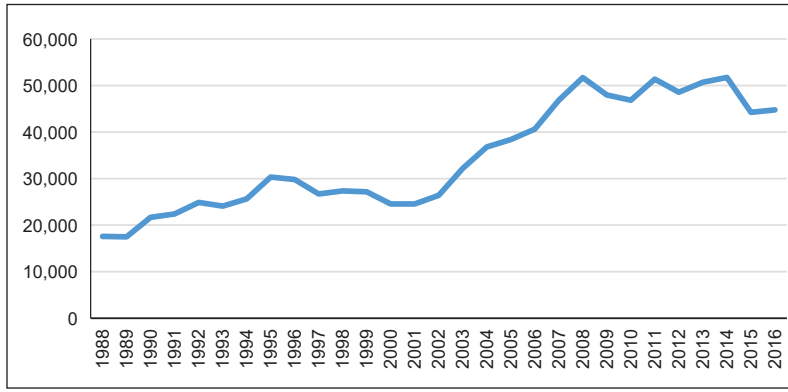

Figure 7.
GDP per capita in Austria (current US$)

Source: WB 2018a

The Freedom House annually analyses the political rights and the civil liberties of many countries, including Austria. In both categories, Austria is given a constant ranking of 1[9] (on a scale 1–7, where 1 expresses the best ranking possible) since the late 1980s until 2017. The Doing Business ranking of the World Bank shows how favourable the business environment in a country is. Analysing the last more than ten years of Austria, we see a positive tendency. The country was able to elevate 10 places in the ranking since 2006, being on rank 22 in 2018 (Figure 8).

[9] On a scale 1–7, where 1 expresses the best ranking possible.

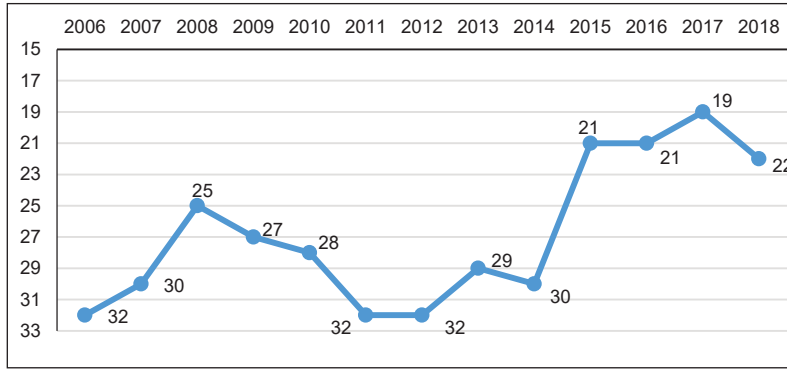

Figure 8.
Doing Business ranking in Austria, 2004–2018
Source: WB 2018b

The Global Competitiveness Index (GCI) depicts a slightly darker picture of Austria's competitiveness in the last 10 years. Austria has fallen back in the ranking (from place 15 to place 19), while the value of the GCI for the country practically remained unchanged in the last decade (Figure 9).

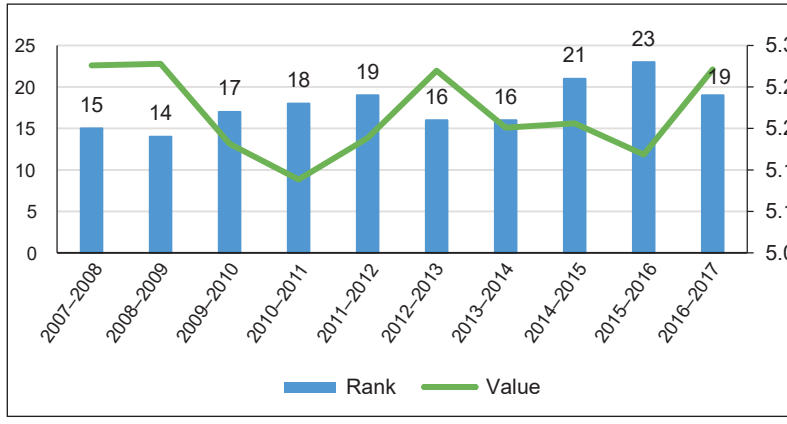

Figure 9.
Global Competitiveness Index in Austria, 2007–2017
Source: Porter–Schwab 2008; Schwab 2011; 2017

To give a more detailed and sophisticated picture on the competitiveness of Austria, there are also two other sub-indices that worth to be shown here. Both in case of infrastructure and innovation, the country's ranking has not practically changed in the last 10 years (Figure 10 and 11). The values of the sub-indices are somewhat higher, which shows some sort of development, but the relative position of Austria has not improved in the last decade.

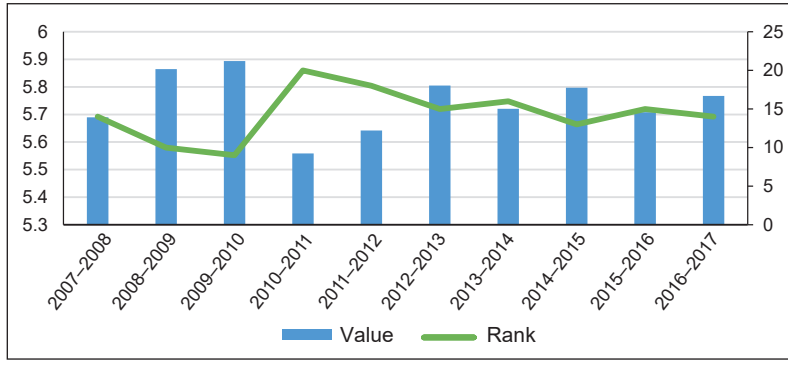

Figure 10.

GCI, 2nd pillar: infrastructure in Austria

Source: Porter–Schwab 2008; Schwab 2011; 2017

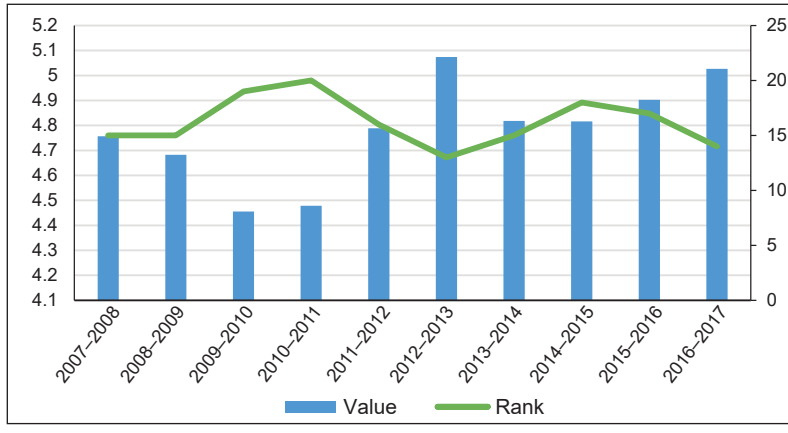

Figure 11.

GCI, 2nd pillar: innovation in Austria

Source: Porter–Schwab 2008; Schwab 2011; 2017

The World Economic Forum lists restrictive labour regulations, high tax rates and inadequately educated workforce as the biggest problems and obstacles to increasing the competitiveness of Austria (Figure 12).

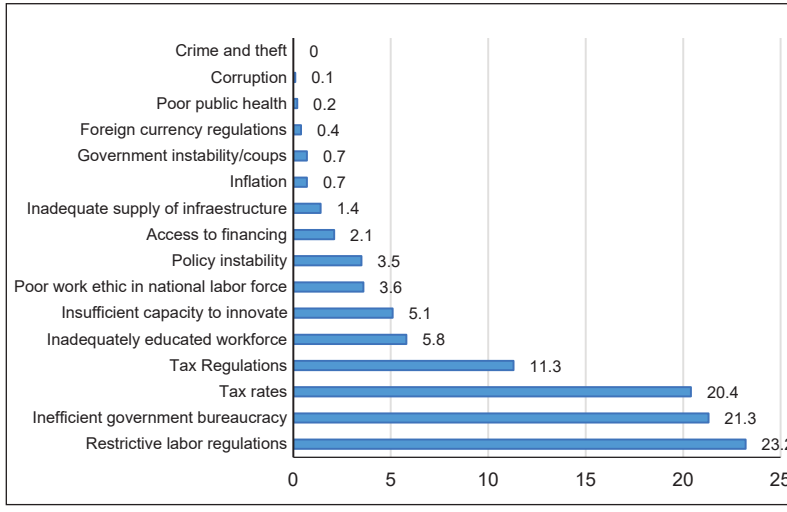

Figure 12.
Most problematic factors for doing business in Austria
Source: Schwab 2017

The World Bank Worldwide Governance Indicators (WGI) gives a picture on the political and regulatory setup and status of a country. According to two indicators of WGI, Austria's position is slightly improving, practically stagnating. Both political stability and the control of corruption show an unchanging picture in the last 20 years (Figure 13 and 14).

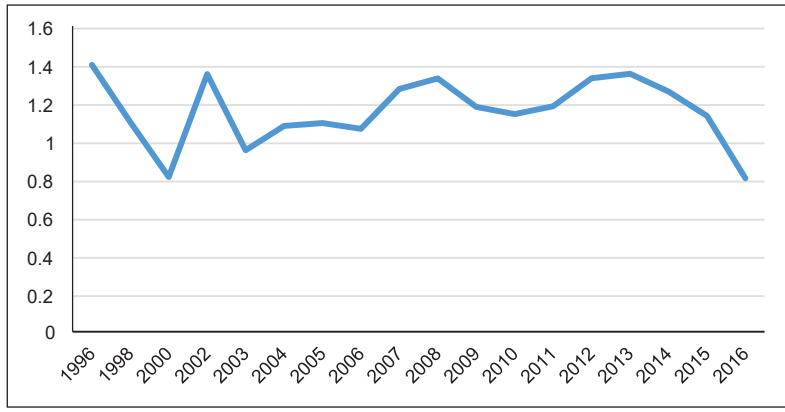

Figure 13.
Political stability in Austria

Source: WB 2016

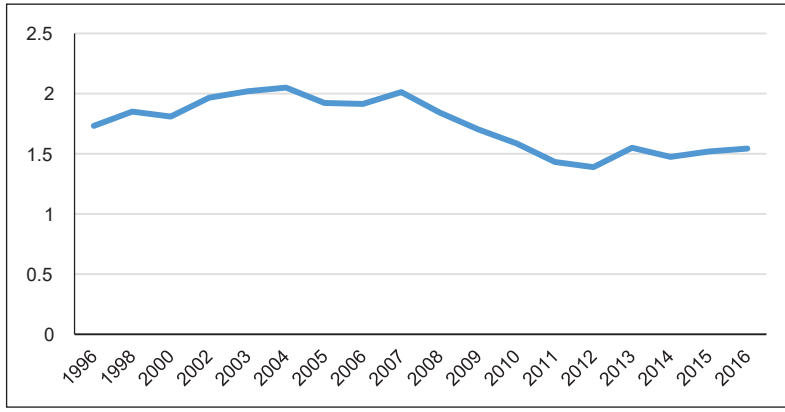

Figure 14.
Control of corruption in Austria

Source: WB 2016

Interdependence and Economic Penetration

When analysing economic integratedness and dependence, we concentrate on three key pillars. First, trade connection, both export and import, second, foreign direct investments and third, globalisation indices. First, in this section, we discuss the trade relations of Austria. As we can see in Figure 15, the value of the export of Austria increased significantly in the last more than 20 years, practically since the EU accession of Austria in 1995, with a sharp fallback in 2008–2009, which has been partly recovered by now. Increased export (and import) volumes clearly show the increased and deep economic integratedness of Austria into the global, more specifically, into the European economy.

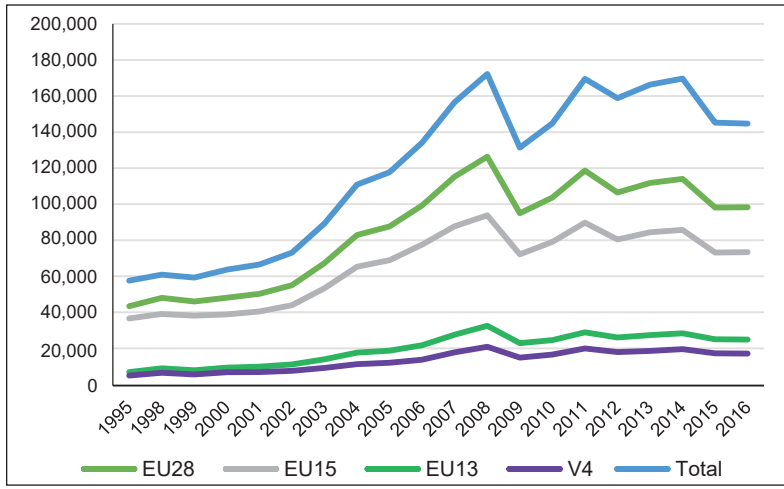

Figure 15.
The value of export of Austria (million USD)
Source: UN Comtrade 2016

Figure 16 shows that the EU Member States are still the most important target destination of the country's export. Nevertheless, its importance is gradually decreasing. Right after Austria's EU accession, the export to the other EU Member States increased, but since 1998, it is gradually and stably decreasing. It has lost 11 percentage points in approximately 20 years (from 79% to 68%).

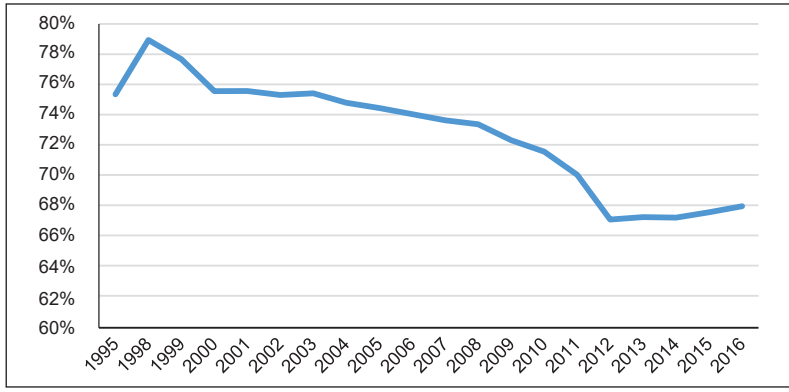

Figure 16.
EU export share of total Austrian export
Source: UN Comtrade 2016

When we analyse the intra-EU target destinations of Austrian export, we could observe that "old", EU15 Member States play a decreasing role for Austrian exporters. On the other hand, new, EU13 Member States, including the Visegrád 4 (V4) countries play a gradually more important role as the target markets of Austrian export (Figure 17).

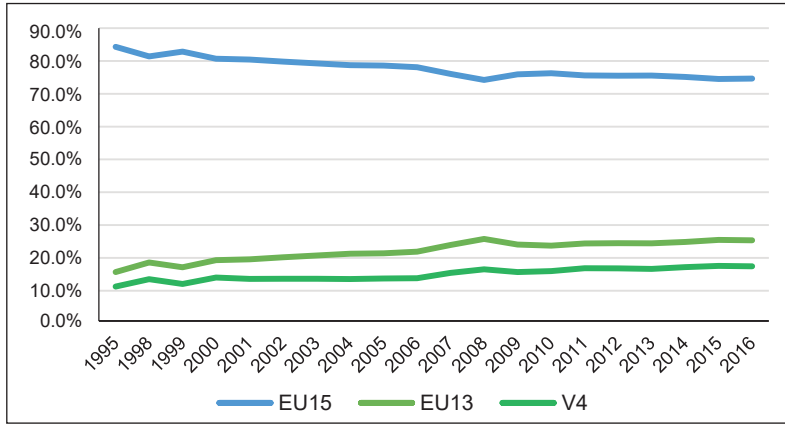

Figure 17.
Share of country groups in intra-EU Austrian export
Source: UN Comtrade 2016

In the context of economic dependency, we need to devote attention to the dependence of Austria on its main export partner, Germany. Over the last 20 years, we see a decreasing role of Germany as the target market of Austrian products. Germany, though still the main export partner for Austria, lost some importance. Germany accounts for 30% of the total Austrian export and some 45% of the Austrian export going to the EU market.

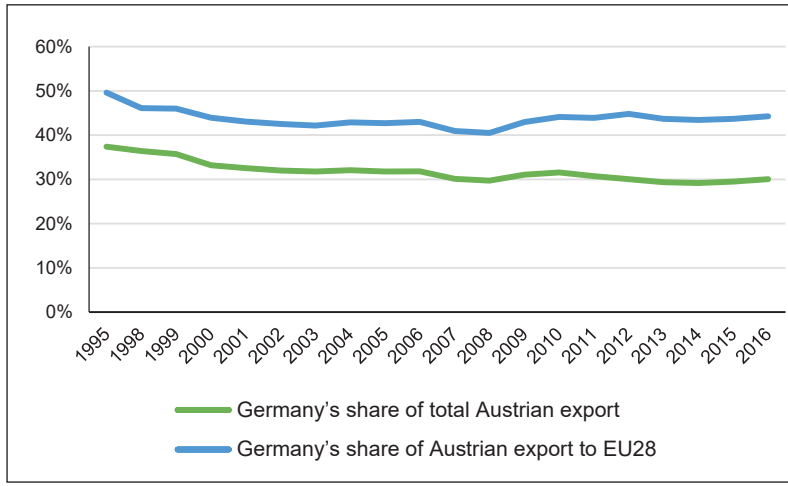

Figure 18.
Germany's share in Austrian export

Source: UN Comtrade 2016

Germany's importance is also corroborated in Table 2. It shows that Germany's leading role as an export partner is unquestionable. The most important tendency is the growing share of EU13 Member States, especially, Austria's neighbouring countries. In the year 2016, half of the ten most important export partners are Central and Eastern European (CEE) countries: the Czech Republic, Hungary, Poland, Slovakia and Slovenia.

Table 2.
Austria's main export partners in selected years

1995			2004			2016		
Member State	**Export value (USD)**	**Share in total export to EU MSs**	**Member State**	**Export value (USD)**	**Share in total export to EU MSs**	**Member State**	**Export value (USD)**	**Share in total export to EU MSs**
Germany	21,523,435,109	49.6%	*Germany*	35,540,423,869	42.9%	*Germany*	43,505,236,553	44.3%
Italy	4,939,673,892	11.4%	*Italy*	9,486,618,660	11.4%	*Italy*	8,984,490,970	9.1%
France	2,393,691,130	5.5%	*United Kingdom*	4,657,925,601	5.6%	*France*	5,752,961,242	5.9%
Hungary	2,057,752,363	4.7%	*France*	4,650,268,538	5.6%	*Czech Republic*	5,161,920,000	5.3%
United Kingdom	1,797,438,515	4.1%	*Hungary*	4,162,393,605	5.0%	*Hungary*	4,727,474,260	4.8%
Netherlands	1,593,164,512	3.7%	*Czech Republic*	3,392,758,136	4.1%	*United Kingdom*	4,304,617,899	4.4%
Czech Republic	1,535,381,284	3.5%	*Spain*	2,711,859,624	3.3%	*Poland*	4,161,604,608	4.2%
Spain	1,142,784,460	2.6%	*Slovenia*	2,426,455,561	2.9%	*Slovakia*	3,069,715,555	3.1%
*Belgium**	948,578,762	2.2%	*Netherlands*	2,051,127,374	2.5%	*Slovenia*	2,854,988,844	2.9%
Slovenia	939,018,301	2.2%	*Poland*	1,995,475,266	2.4%	*Spain*	2,539,621,885	2.6%

*Belgium and Luxembourg together

Source: UN Comtrade 2016

Similar tendencies can be observed based on Austria's import relations. Austria's main import partners are EU countries, with a growing share and importance of new Member States (EU13), including the V4 countries. Similarly to the trendlines of export, the value of import has fallen sharply in the 2008–2009 economic crisis, which has been somewhat recovered but still has not reached the pre-crisis level (Figure 19).

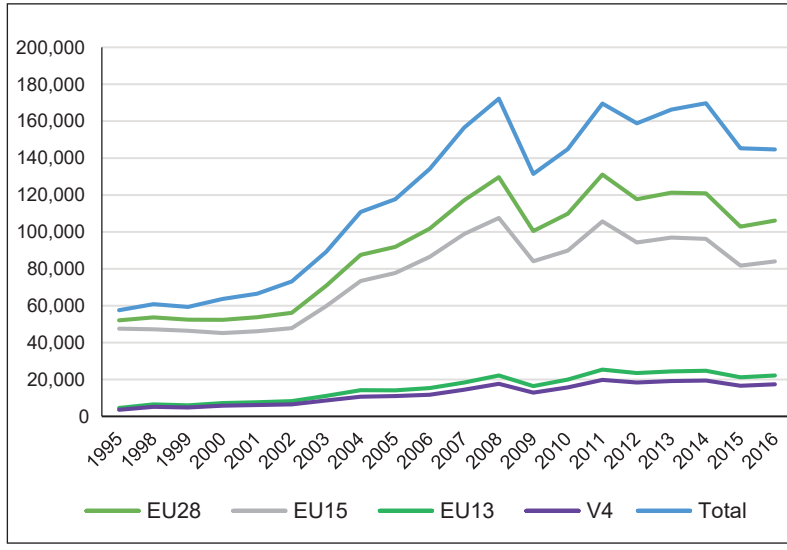

Figure 19.

The value of import of Austria (million USD)

Source: UN Comtrade 2016

Figure 20 shows that import from the EU Member States is gradually decreasing in the case of Austria. From 90% in 1995, it has moderated to 75% in 2016.

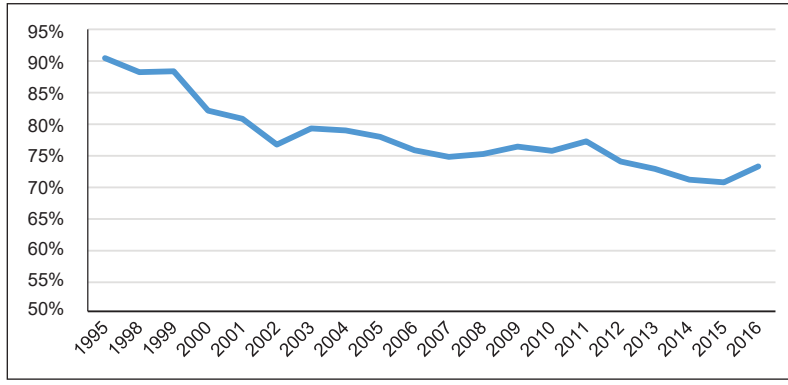

Figure 20.

EU import share of total Austrian import (%)

Source: UN Comtrade 2016

Figure 21 shows that Austria's import dependency on the EU is higher (80% in 2016) than that of export (75% in 2016) to the EU. Approximately 80% of all the import comes from the EU Member States. During 20 years, EU15 import decreased 10 percentage points, while EU13 import increased the same percentage points.

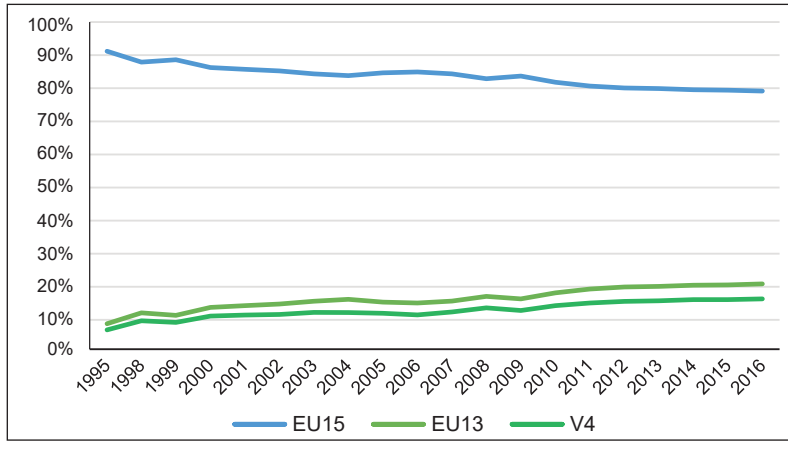

Figure 21.

Share of country groups in intra-EU Austrian import (%)

Source: UN Comtrade 2016

Similarly to the export relations, we should take a look at Austria's import dependency on its main trading partner, Germany. We see a somewhat higher dependency in the field of import than in the export. More than 50% of all EU import comes from Germany to Austria, which means that almost 40% of all Austrian imports is originated from Germany (Figure 22).

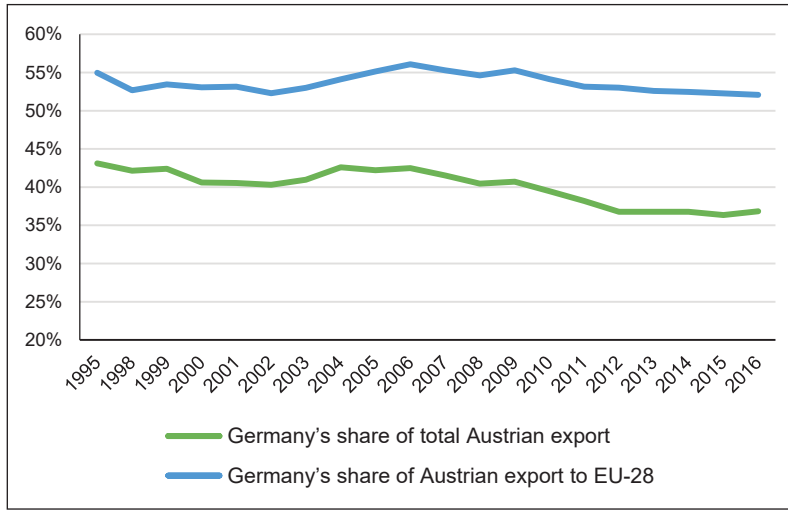

Figure 22.
Germany's share in Austrian import
Source: UN Comtrade 2016

Finally, regarding Austria's main import partners, we see that Germany, Italy and France have been the key import partners throughout the last two decades. Nevertheless, while in 1995, only two CEE countries—the Czech Republic and Hungary—had a position in the top 10 import partners, in 2016, there were four, also including Poland and Slovakia. This shows the deepening trade ties between Austria and the CEE countries (Table 3).

Table 3.
Austria's main import partners in selected years

1995			2004			2016		
Member State	**Import value (USD)**	**Share in total import from EU MSs**	**Member State**	**Import value (USD)**	**Share in total import from EU MSs**	**Member State**	**Import value (USD)**	**Share in total import from EU MSs**
Germany	28,631,225,171	43.1%	*Germany*	47,396,423,650	42.6%	*Germany*	55,258,735,966	36.8%
Italy	5,788,342,941	8.7%	*Italy*	7,543,831,359	6.8%	*Italy*	9,142,014,784	6.1%
France	3,239,313,864	4.9%	*France*	4,448,732,013	4.0%	*Czech Republic*	6,481,184,490	4.3%
Netherlands	2,266,781,639	3.4%	*Czech Republic*	3,509,507,701	3.2%	*France*	4,004,206,667	2.7%
United Kingdom	1,955,530,152	2.9%	*Hungary*	3,388,177,518	3.0%	*Hungary*	3,893,438,755	2.6%
Belgium	1,755,635,070	2.6%	*Netherlands*	3,119,539,414	2.8%	*Netherlands*	3,835,931,558	2.6%
Czech Republic	1,240,458,904	1.9%	*Slovakia*	2,387,591,329	2.1%	*Poland*	3,679,549,349	2.5%
Hungary	1,234,738,709	1.9%	*United Kingdom*	2,150,186,726	1.9%	*Slovakia*	3,279,111,516	2.2%
Sweden	1,099,624,284	1.7%	*Belgium*	1,872,992,497	1.7%	*United Kingdom*	2,796,028,744	1.9%
Spain	867,432,696	1.3%	*Spain*	1,735,041,892	1.6%	*Spain*	2,683,539,984	1.8%

Source: UN Comtrade 2016

In addition to trade processes, in this section we discuss the FDI relations of Austria. Regarding FDI, we could also see a significant increase in the FDI stock in Austria. Total FDI stock has increased five times between 2001 and 2012. The most impressive increase could be observed regarding the FDI from the EU13 Member States, especially the V4 countries. We can conclude that strong trade and investment relations between Austria and EU countries largely contributed to a massive FDI inflow to the country (Table 4).

Table 4.
FDI stock in Austria (million USD)

	2001	**2002**	**2003**	**2004**	**2005**	**2006**
Total	34,999	44,896	57,637	70,713	82 552	113,612
EU15	27,251	32,659	41,655	51,715	58,882	84,180
EU13	96	104	140	255	284	1,141
V4	62	58	23	46	41	47

	2007	**2008**	**2009**	**2010**	**2011**	**2012**
Total	162,455	148,131	172,636	161,168	15,3097	164,363
EU15	105,819	105,321	110,671	103, 483	94,750	100,624
EU13	2,682	1,180	1,553	1,701	1,528	2,000
V4	100	239	288	207	289	546

Source: OECD 2013

We can also conclude that FDI from the EU Member States plays the most important role in Austria. Nevertheless, the share of this FDI is gradually decreasing, from around 80% in the early 2000s to 60% by 2012 (Figure 23).

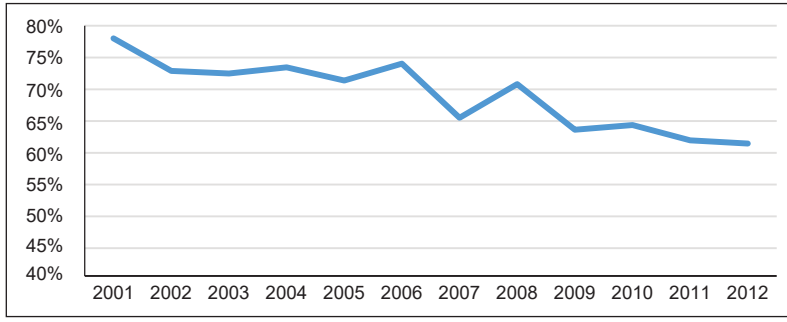

Figure 23.
EU share of total FDI stock in Austria
Source: OECD 2013

As stated above, economic integration and connectedness could be expressed by capital flows. Foreign Direct Investment statistics of Austria shows that FDI inflow has increased after the country's EU accession in 1995. We can observe very high values before the 2008 economic crises and a very volatile period after that (Figure 24).

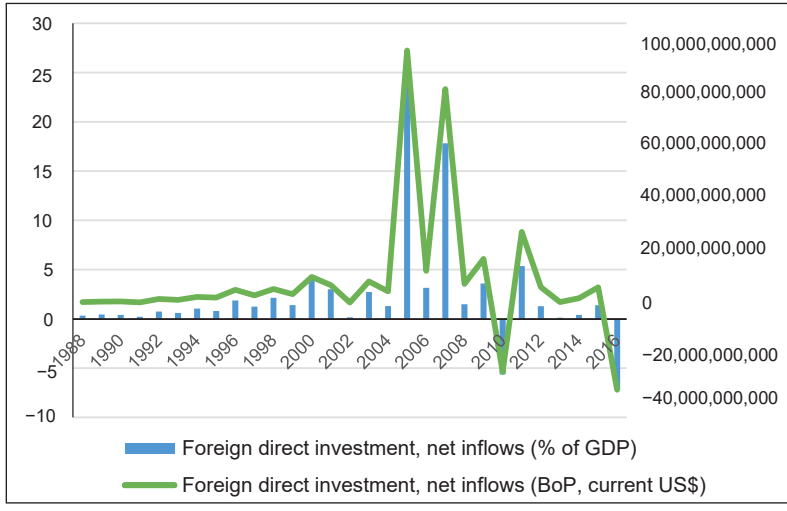

Figure 24.
Foreign Direct Investment inflow in Austria, 1988–2016
Source: WB 2017a

A similar tendency could be observed based on FDI outflow data. Slight increase after Austria's EU accession, followed by a high level of capital outflow after 2004. The reason behind this latter tendency is the 2004 enlargement of the EU, which paved the way for Austrian companies' investments in the new, neighbouring Member States, mostly Hungary, Slovakia, the Czech Republic and Slovenia. This upward trend was curbed by the 2008 crisis (Figure 25).

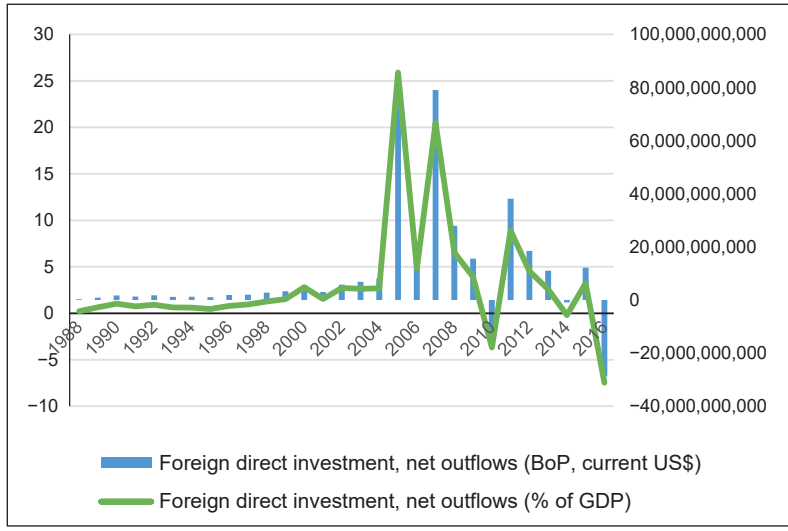

Figure 25.
Foreign Direct Investment outflow in Austria, 1988–2016
Source: WB 2017b

Austrian FDI stocks are "regional" rather than "global", which means that they are strongly focused on Europe, especially Central and Eastern European countries. Almost 50% of total Austrian outward FDI stocks in 2008 were invested in these countries. In 2008, Austria was the most important investor in six CEEC (Slovenia, Bosnia and Herzegovina, Croatia, Serbia, Romania and Bulgaria) and ranked high in some other CEEC, namely Slovakia, Hungary and the Czech Republic (Table 5). Austria's extraordinarily strong position as an investor in CEEC is also emphasised by the market shares. In 2008, Austria's share in the total inward FDI of the CEEC was 8.2%,

whereas in global inward FDI Austria only had a market share of 0.9%. (Breuss–Landesmann 2010) The most important country for Austrian outward FDI in 2008, however, was still Germany. Austria invested € 2.6 billion in the largest European economy and Austrian FDI stocks in Germany amounted to € 15 billion or 14.2% of total Austrian FDI stocks.

Table 5.
Austrian position as an investor in CEEC in 2008

Country	Rank	Percentage shares in FDI stocks
Slovenia	1	46.6
Bosnia and Herzegovina	1	30.4
Croatia	1	29.1
Serbia	1	20.3
Romania	1	18.8
Bulgaria	1	18.4
Slovakia	2	14.5
Hungary	3	12.7
Czech Republic	3	12.1
Macedonia	4	11.3
Albania	4	8.7
Montenegro	7	7.2
Ukraine	5	6.5
Poland	9	3.5

Source: Breuss–Landesmann 2010

In 2009, Austria's inward FDI flows amounted to € 6.2 billion, which was one third higher than in 2008. Inward FDI stocks totalled € 106.2 billion. A major part of the investment was held by EU15 countries; almost 70% of the stock originated from there. The most important investors in Austria are Germany, Italy and the USA. (Breuss–Landesmann 2010)

Last but not least in this section, we examine globalisation indices of Austria. Globalisation indices express a country's involvement and integratedness into the global economy and society by quantifying and analysing the economic, political and social ties of the country to other countries.

The Economic Complexity Index (ECI) expresses a country's capability and prospects to integrate into the global economy. We can observe a negative tendency in Austria regarding this index, as its value has generally been decreasing in the last almost 30 years (Figure 26).

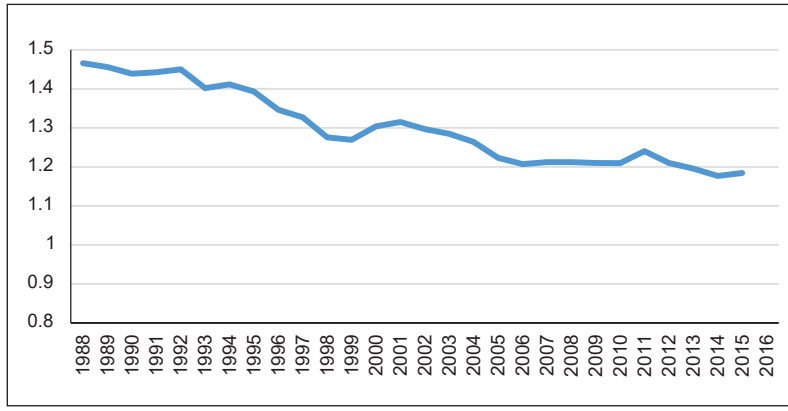

Figure 26.
Economic Complexity Index in Austria, 1988–2016
Source: OEC[10] 2016

The KOF Globalization Index shows the picture of a gradually integrated Austria into global economic, social and political relations (Figure 27). It has three, reinforcing explanations. First, the fall of the iron curtain in 1989–1990 opened up the Eastern borders of Austria, creating the opportunity to establish economic and political ties with a number of Central and Eastern European, former socialist countries. Second, Austria's EU accession in 1995 made the country part of the most advanced region of the continent. And finally, the introduction of the Euro, the accession of Austria to the Eurozone made the country belong to the very core, developed and integrated part of the European Union.

[10] OEC: The Observatory of Economic Complexity.

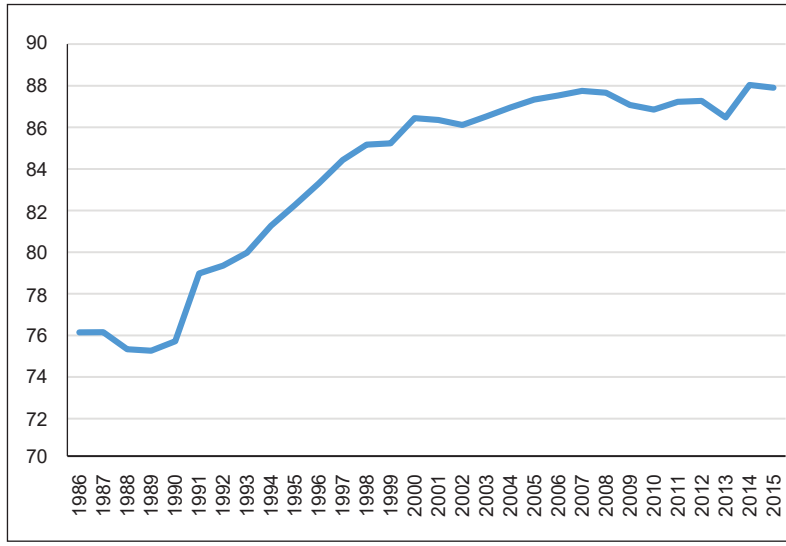

Figure 27.
KOF Globalization index in Austria, 1988–2014
Source: ETHZ[11] 2015

We can see in Figure 28 that the DHL Global Connectedness Index also shows a somewhat different picture. Both Austria's score and ranking has deteriorated in the last decade. Nevertheless, the country is still very opened and integrated into global tendencies, which is reflected by the high ranking (best 20 countries in the world).

[11] ETHZ: ETH Zürich.

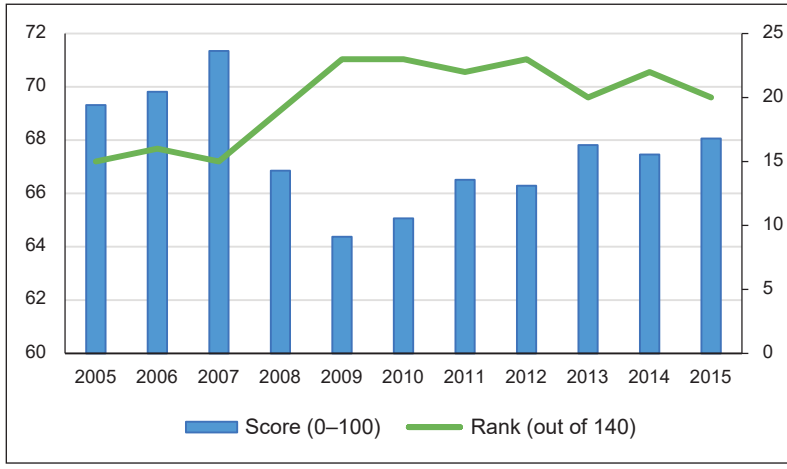

Figure 28.
DHL Global Connectedness Index in Austria

Source: DHL 2015

Conclusion and Outlook: Drawing the Balance of the Results of Integration

In the triangle of economic transformation, economic integration and economic dependency, we can draw some key conclusions regarding Austria. These are as follows:

- Austria has witnessed four major steps towards a more opened economy in the last 30 years:
  - the fall of the iron curtain and the Eastern opening that followed;
  - the European Union accession in 1995;
  - the accession to the Eurozone in 1999;
  - the Eastern enlargement of the European Union in 2004 and 2007.

  All these phases have significantly contributed to opening up the economy of the country as well as making it more integrated into the EU as well as more globalised.
- Austria's traditional main trading and investment partners—both export and import as well as outward and inward FDI—have been Germany and Switzerland. Nevertheless, with the fall of the iron

curtain and the consequent Eastern expansion of Austria, their share has diminished in the last decade.

- Similarly, the role of the European Union as Austria's main trading partner has slightly decreased. Among the EU Member States, the share of EU15 has decreased, while EU13 has counted for an increasing share within the EU total.
- Austria is a net contributor country to the European Union budget since its accession in 1995. The overall balance of the EU accession is a topic of discussion in the country. The positives are the increased level of trade and investment, opposing this, there are the issues of politically sensitive topics, like migration, loss of jobs, decreasing labour costs, the problems of the Eurozone, etc.
- Austria and its companies have capitalised on the Eastern opening: today, Austria is the most important investor in some CEE and Balkan countries. In terms of outward FDI, Austria has key positions in V4 countries—especially Hungary and Slovakia—as well as Slovenia and Croatia.
- Regarding the globalisation indices, Austria has seen an upward trend in the last three decades, which is the consequence of the gradual political, social and economic opening of Austria since the fall of the iron curtain.

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Chapter 2.

Economic Integration and Interdependence in Croatia

The Last Shall be the First? From Late-comer in Central and Eastern Europe to Front-runner in the Western Balkans

Fruzsina Sigér

The Conditions at the Beginning of the Integration Process[1]

In 1989 Croatia was the second most developed republic of Yugoslavia and when it became independent, it was one of the most developed transformation economies, particularly among Southeastern European countries (SEE). It began its transformation as a relatively industrialised and open country. The openness was not only significant in terms of trade, but also because of the large tourist sector and the notable size of Croatian diaspora who worked in the West as guest-workers. The share of the tertiary sector was relatively high undoubtedly due to the tourism sector. In the late 1980s, Croatia had every chance to shift from a middle-income country to a developed one. (Bićanić 2001; Bartlett 2003) At the time of the regime changes in Eastern Europe, Yugoslavia was better positioned to make a successful economic and political transformation than most of the peer countries in the region. (Woodward 1995) It is a telling fact that in its Economic Survey of Europe, the United Nations Economic Commission for Europe (UNECE)

[1] This section is based on Sigér 2010.

https://doi.org/10.36250/00801_03

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classified Yugoslavia among "Western Europe and North America" instead of "Eastern Europe and the Soviet Union" until 1993, although Yugoslavia was a planned economy, even if not a classical central planned one.

The transformation of Croatia did not begin in 1991 when it became independent but well before, during the Yugoslav times. Therefore, Croatia has inherited the Yugoslav path of transformation. Although the establishment of the independent statehood was not reached peacefully, the creation of the individual Croatian economy was smooth and its costs were low. Due to the federal structure of Yugoslavia, the republics enjoyed a high level of independence regarding their economic policy. With the dissolution of the federal state, Croatia quitted form the convoy of Yugoslavia and got the opportunity to shape its own transformation policy and concentrate on specific Croatian problems. (Bićanić 1994) At the time when Croatia gained independence, its economy (and the whole Yugoslavian economy) was in the middle of recession. The Yugoslav economy experienced severe problems since the 1970s that manifested in growing external debt, accelerating inflation, stagnating or even decreasing output and increasing unemployment. The war in 1991 led to the acceleration of prices again. (EIU[2] 1996, 40) The consumer prices increased in 1992 by 1.038% and in 1993 by 1.249%. The stabilisation steps proved to be very successful, retail price inflation decreased from a monthly rate of 38.7% to 1.4% in November, i.e. in the next month, and it was even negative (–0.5) in December. The low inflation proved to be sustainable. The World Bank (WB) labelled the stabilisation program as one of the most successful in the region. (WB 1997) In answering the question of why was the program successful, Škreb (1998) highlights that the initial conditions were so bad that hardly anything could have worsened it. At the same time, the program included a good mix of monetary and fiscal policy and enjoyed strong political and popular support that made both the government and the HNB[3] enable to implement it.

[2] EIU: The Economist Intelligence Unit.

[3] HNB: Hrvatska narodna banka (en – Croatian National Bank).

The GDP per capita in 1990 in Croatia was around the average of the Central and Eastern European (CEE) countries. However, the decline of the GDP of the early 1990s was deeper in Croatia than that of the CEE or SEE countries (Figure 1). The transformational recession[4] of Croatia was exacerbated by the break-up of the Yugoslav market and by the Yugoslav war. In 1991, partly due to the explosion of the war, the GDP fell with 21.1% and by 1994 it reduced to two-thirds of the pre-war level. However, the magnitude of fall in the GDP per capita was in line with the CEE average (Figure 2). The cost of the dissolution was less severe than in the Commonwealth of Independent States (CIS) region.

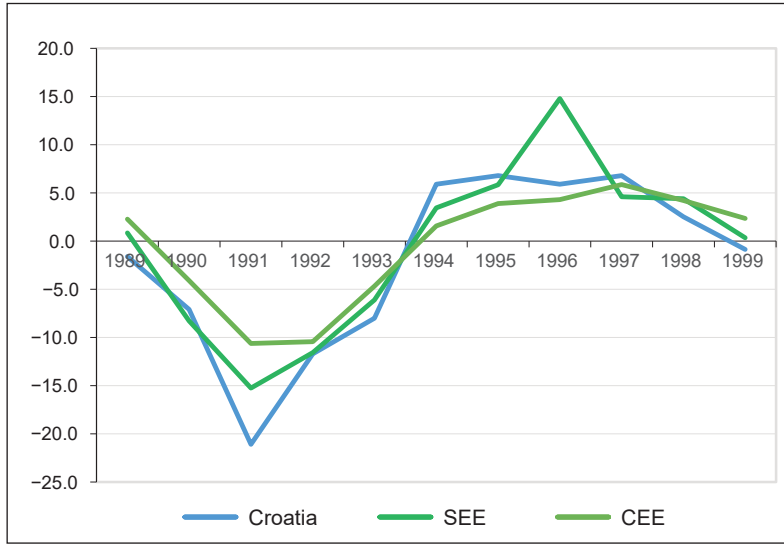

Figure 1.

GDP year-on-year rate of growth in real terms in Croatia, 1989–1999

Note: In 1996 and 1997 Bosnia and Herzegovina experienced an extraordinary growth rate (86% and 37% respectively) that increases the (SEE) average as well.

Source: EBRD[5] s. a.

[4] Cf. Kornai 1993.

[5] EBRD: European Bank for Reconstruction and Development.

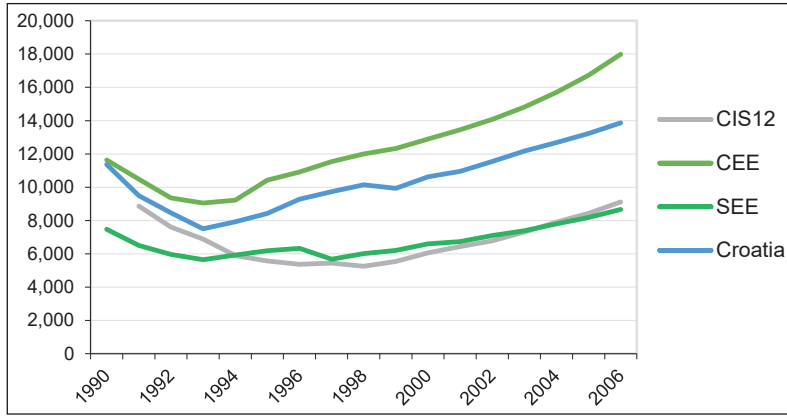

Figure 2.
GDP per capita, in international comparable prices by expenditure, at prices and PPPs of 2005 in USD

Source: UNECE s. a.

As a result of the macro-stabilisation programs, the negative growth of the GDP stopped and it turned into a positive trend. The post-war reconstruction activity, among others housing and infrastructure spending, provided another important impetus to growth. Consumer spending and private-sector investment, both of which were postponed during the war, also contributed to the growth in 1995–1997. However, the consumer boom was disrupted when the economy went into recession in mid-1998. The reason for the downturn was the 1998–1999 bank crises, during which 14 banks went bankrupt.

Concerning the structure of the economy, the share of the tertiary sector has been relatively high since the beginning of the 1990s, undoubtedly due to the tourism sector. The structural problems and the lack of competitiveness of many export sectors, which were common among the transformation economies, were exacerbated by the disruption caused by the war and the loss of much of the Yugoslav market. (EIU 2000) During the war, heavy industries such as shipbuilding and metal products were regarded as strategically important and thus were kept afloat by the government with generous subsidies. The importance of shipbuilding continued after the war. Its output rose by 20.6% year on year in 1998 and by 12.6% in 1999. Shipbuilding exports reached 782 million in 1998, making shipbuilding the largest single export sector.

Open unemployment already existed in Yugoslavia. That is why the initial transformation effect on the unemployment rate in Croatia was smaller than in other countries. At the same time, the war made the transformation recession deeper that was reflected in the labour market, as well. The consistently high unemployment rate was partly a consequence of the insufficient Foreign Direct Investments (FDI) inflow but also the legacy of the Yugoslav self-management system and thus the insider capitalism. (Soós 1986) The overall employment fell dramatically in 1991–1992, partly due to the war-related loss of population (Figure 3). From 1993 change in employment converged with the peer countries average and until 1997 the change in employment was negative, in line with the peer countries average. The labour productivity per person employed in Croatia was in line with that of the CEE countries.

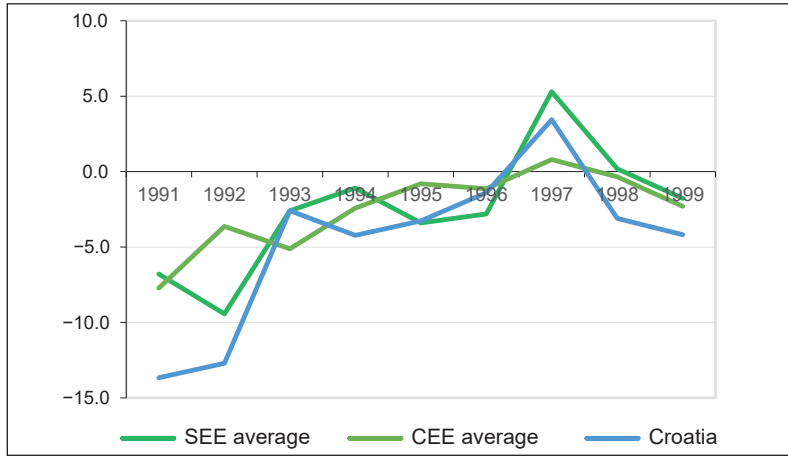

Figure 3.

Percentage change in employment (end-year) in Croatia, 1991–1999

Note: Data based on labour force surveys (LFS).

Source: EBRD s. a.

Compared to the Human development index (HDI) of the future EU28 countries in 1990, Croatia had the lowest value (0.669) (Figure 4). The average of the future EU28 was 0.753 and all the other countries reached at least 0.700 points. The armed conflict in Croatia had a crucial impact on the HDI in the early 1990s. Later, with the end of the war, a fast catching-up process started.

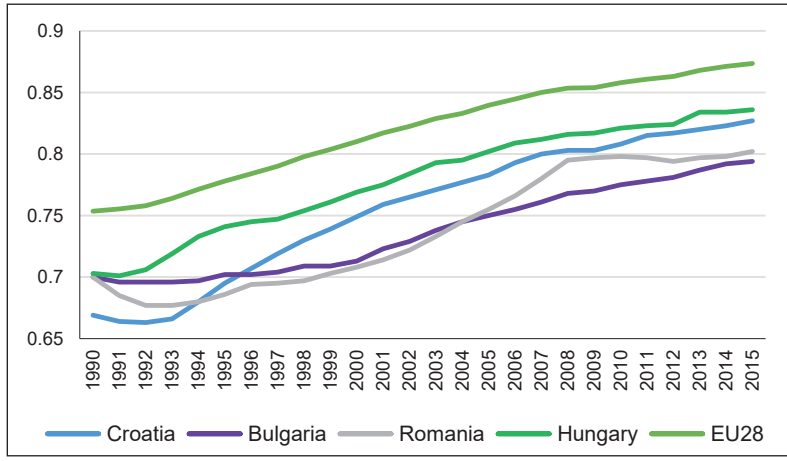

Figure 4.
Human Development Index (HDI), 1990–2015
Source: UNDP[6] s. a.

Interdependence and Economic Penetration

With the dissolution of Yugoslavia, the inland trade with the former federal republics became foreign trade that, by definition, made the Croatian economy more open. When declaring its independence in 1991, Croatia's imports of goods and services in % of GDP ratio was 86% i.e. it was much more open than former Yugoslavia ever was. (Vujčić–Šošić 2004) However, the economy of Croatia was rather closed during the 1990s: by 1994 the openness ratio declined to 46% and it stayed between 49% and 57% during the decade. The war disrupted the trade links with the Eastern parts ofthe former Yugoslavia and as a result, the Croatian export focused more towards the EU. The share of the EU decreased slightly in the post-war years (Table 1). Whereas the CEE peer countries had association agreements with the EU, which gave them

[6] UNDP: United Nations Development Programme.

tariff-free access to EU markets, this was missing in case of Croatia. Among EU countries Germany, Italy and Austria were the main trade partners of the country while Slovenia and Bosnia and Herzegovina among the former Yugoslav republics. Most non-tariff barriers were removed in 1996. The growth of import was stronger during the 1990s than the export growth, leading to a near tripling of the trade deficit. The post-war GDP recovery was based on an expansion in domestic demand. (Šonje–Vujčić 1999) The export underperformed; its growth rate was much under the CEE average.

Table 1.
Trade by main export partners 1994–2016

	1994	1999	2010	2016
Exports				
EU	59%	49%	61%	66%
Italy	N/A	18%	30%	14%
Germany	N/A	16%	17%	12%
Slovenia	13%	11%	13%	12%
BiH	8%	13%	12%	9%
Imports				
EU	59%	57%	60%	77%
Germany	N/A	19%	21%	16%
Italy	N/A	16%	25%	13%
Slovenia	10%	8%	10%	11%
Austria	N/A	N/A	8%	8%

Source: EIU 1996; 2000; DZS[7] s. a.

Concerning the direction of trade, the main trading partner of Croatia has been the EU from the beginning of its independence. Despite its small size, Croatia remained a relatively closed economy at the beginning of the new millennium. Exports of goods and services represented only 45% of GDP in 2000, compared with 60–75% for most countries in Central and Eastern Europe. Following political changes in 2000, the EU withdrew most of the barriers to Croatian exports and granted preferential access for export of textiles. The change in government also removed the political

[7] DZS: Državni zavod za statistiku (en – Croatian Bureau of Statistics).

obstacles of the World Trade Organization (WTO) membership; in July 2000 Croatia joined the WTO. According to the agreement, Croatia committed to agricultural and industrial protection by 2005 and the liberalisation of fixed-line telecommunication services by 2003. (EBRD 2000, 150) Croatia requested to accede to the Central European Free Trade Agreement (CEFTA) in July 2001 and the accession treaty was signed in December 2002.[8]

Concerning the structure of export to the European Union, it developed unfavourable during the second half of the 1990s. In 2006, when the first chapter of the accession negotiations was opened, the structure of export was characterised by a high share of labour- and capital-intensive industries and a low share of technology-driven industries. The most important export product group was machinery and transport equipment (36.1%). Within this sector, shipbuilding still accounted for around 30% of the total export. The export performance of the manufacturing industry was poor in spite of the high level of FDI inflow into this sector. This suggests the low return on investments.

The EU accession meant changes in Croatian foreign trade, partly because of entering the single market, but also due to the simultaneous exit from CEFTA. Concerning the direction of trade, the main trading partner of Croatia has been the EU long before the accession. Trade liberalisation started with the Stabilization and Association Agreement in 2001 which was asymmetrically in favour of Croatia. The EU has granted Croatia duty-free access to its markets for almost all products except for veal meat, seafood products and wine. At the same time, Croatia completely eliminated its custom duties on imports of industrial products from the EU by 2007 and reduced tariffs on agricultural products and fisheries. From 2007 to 2013 foreign trade with EU27 countries reached 60% of the total Croatian foreign trade which made the EU its most important trading partner. Since 2013 both exports to the EU and imports from the EU has been continuously increasing. The largest Croatian trading

[8] CEFTA was redesigned in 2006 in the framework of the Stability Pact and was extended to the countries in SEE. The aim of the CEFTA remained to improve the readiness of parties for membership in the European Union.

partners from the EU are Germany, Austria and Slovenia. With almost all member states Croatia records trade deficit. In 2015 Croatia belonged to the group of member states that are net importers of goods not only in their trade with European Union partners but also with trade partners outside of the EU. Croatia's share of total EU28 export is relatively low (0.3%) and equals the size of the share of Latvia or Estonia.

Despite its small size, Croatia still proves to be a relatively closed economy: exports of goods and services represented only 51.4 % of GDP in 2016, compared with 60–90% for most countries in Central and Eastern Europe. Access to the single market significantly improved the export capacity of Croatian companies. Still, Croatian firms appear to be less integrated into global value chains and to be less involved in inter-industry trade compared to other Central and Eastern European firms. As a relatively late-comer, Croatia missed the wave of expansion of western manufacturing CEE peers experienced. (Orsini 2017) However, EU accession together with economic recovery boosted exports (from 43% of GDP in 2013 to 51.4% in 2016), which also paved the way to a turnaround in the current account balance. Croatian value of exports of goods doubled between 2003 and 2015.

With entering the Single Market Croatia left CEFTA, the member of which it had been since 2003. About 20% of exports went to CEFTA countries, where Bosnia and Herzegovina and Serbia were its biggest trade partners. In 2013 Croatian foreign trade with CEFTA countries started to decrease (the fall in exports was 5.8% and 4.8% in imports right in the first year of EU membership). However, later both imports and exports recovered to the pre-2013 level or even exceeded it (Figure 5 and 6). As during the previous two enlargements, the EU launched consultations with CEFTA countries with which it has signed Stabilization and Association Agreements (Albania, Bosnia and Herzegovina, Montenegro, Macedonia and Serbia) regarding the mitigation of changes in terms of exports for Croatia. According to this, from the day of accession, Croatia enjoyed duty-free bilateral trade in industrial products without a period of adjustment and trade in agro-food products at basic, reduced and zero customs rates with these countries. With Kosovo and Moldova Croatia applies duties under the most favoured nation (MFN) status since EU did not sign SAA with the above-mentioned countries. (Štulec et al. 2014)

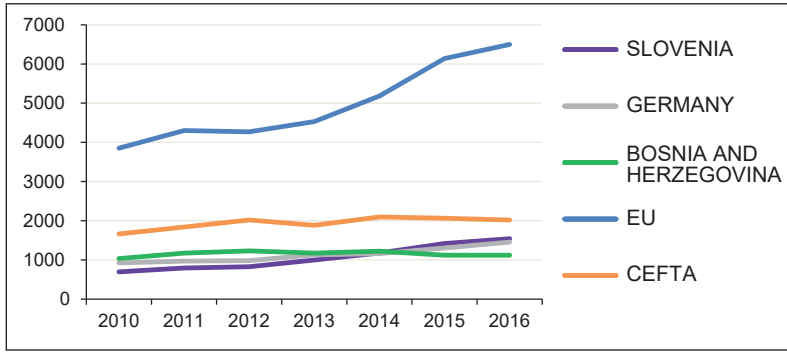

Figure 5.
Exports by countries of destination (Million USD)
Source: DZS s. a.

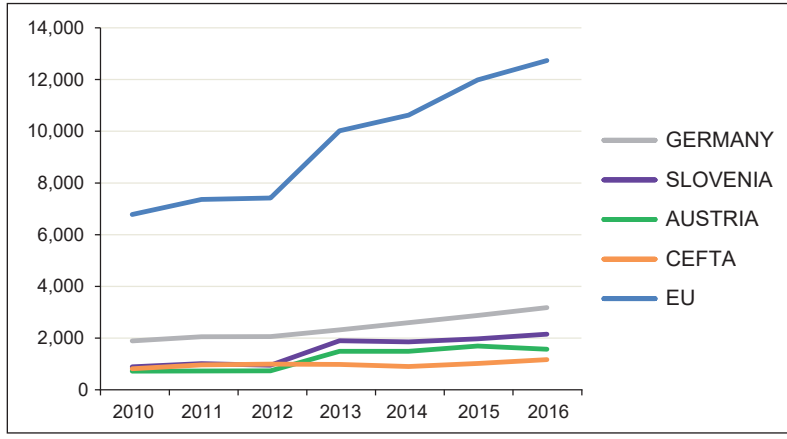

Figure 6.
Imports by countries of origin (Million USD)
Source: DZS s. a.

Traditionally Croatia always had a trade deficit that was compensated by the strong surplus of tourism and remittances. However, tourism is highly sensitive to bad news and the armed conflict in 1991 virtually eliminated tourism incomes. In 1995, the current account deficit reached 7.5% of GDP as a result of the huge trade deficit that was not compensated by the tourist

earnings due to the repeated armed conflict. The tourism industry recovered further in 1996 and 1997 but was still far from the pre-war level and it could only narrow but not eliminate the current account deficit. In 1999, the tourism incomes were disturbed again by the Kosovo conflict, but the current account balance stayed at the level of the peer countries average. With 37% international tourism receipts of total exports in 2015, Croatia stands high above all the other member states in this respect. International tourism plays an outstandingly important role in the country's external position. This sector not only generates revenues but also drives up the import of consumption goods. Contrary to most of the new member states, Croatia's imports appear to be mainly driven by export of services (primarily tourism), while export of goods and investments play only a secondary role. (Orsini 2017) Travel and tourism's direct contribution to GDP in Croatia was 10.7% in 2016, compared with the EU average of 3.7%. The sector's direct contribution to employment is the double of the EU average (10% and 5% respectively in 2016). (WTTC[9] 2017) Compared to EU28, Croatia's tourism activities are much more seasonal. This seasonal character is visible also in the import dependence of the country which is driven by the surge in consumption of non-domestic residents during the peak tourist season. Tourism in Croatia is mainly focused on guests from within the EU. In 2012 only 11% of guest nights were spent by tourists from outside the EU. The top 5 countries of origin were Germany (24%), Slovenia (11%), Austria (9%), the Czech Republic and Italy (both 8%). (Demunter–Dimitrakopoulou 2014) The tourism sector is definitely a beneficiary of the EU accession, although the potential benefits are far from being totally utilised. Croatia is still not a member of the Schengen zone, and becoming a member is certainly a priority for the country. In June 2017 Croatia connected to the Schengen Information System (SIS) which helps to reduce waiting time at Slovenian and Hungarian land borders. This also means that Croatia has met the technical and legal requirements of the Schengen evaluation and a phasing-in process can begin. Foreign Minister Miro Kovač hopes to be fully admitted to the Schengen zone in 2018. (Morgan 2017) As European Commission (EC) President Juncker said in his State of the Union 2017 speech, Croatia should be allowed to become a full Schengen member once it meets all the criteria.

[9] WTTC: World Travel and Tourism Council.

The amount of net foreign direct investments into Croatia remained low during the first half of the 1990s, mainly due to the war. In the mid-1990s the country's current account deficits were mainly covered by external borrowing, whereas FDI inflows were weak. After the war, in the second half of the 1990s, a substantial increase in annual FDI flows took place, peaking in 1999 when the government sold its 35% stake of the public fixed-line telecommunications operator, Hrvatski Telekom to Deutsche Telekom. Beyond Germany, the dominant investors came from Austria and Italy. However, the FDI per capita stayed significantly below the CEE average during the Tudjman regime, albeit it exceeded the average of Romania and Bulgaria. Although the war was over, the legacy of the Yugoslav self-management model and the economic nationalism in the country made the investors cautious. Foreign investors were deterred by the non-transparent relationship between the ruling party and favoured businesspersons. There were many incidents reported by foreign investors that they had been defrauded by local partners. (EBRD 2000)

The primary form of the Croatian privatisation process was the management and employee buyouts. About half the shares in each company were to be sold at a discount price to employees. By mid-1995 about 3,000 schemes were submitted and two-thirds of them were approved. (EBRD 1995) In 1998, the first round of mass voucher privatisation scheme was introduced. Primarily it intended to benefit the victims of the war and communism. While a number of large banks, Telekom and the first part of INA were sold, the state kept many firms out of privatisation and other firms could not find buyers and the state acted as a buyer of last resort. Again others were used as "milk-cows", which were returned to the state after their assets were taken out. (Bićanić 2001) In the "golden" age from 2004 to 2009 (Figure 7), the second stage of the sale of INA and the telecommunications was carried out. (*White Book* 2017) The most important motivation of foreign investors in the majority of Central and Eastern European countries have been the low labour costs. In Croatia, most of the investors either entered the country to increase their market share by capital increases and takeovers or to take part in the privatisation process as strategic investors, although the method of privatisation (manager and employee buy-out and later voucher privatisation) was not really in favour of FDI. Accordingly, most of the foreign investments took place in already existing capacities. The number of greenfield projects has been below potential, partly due to the unfavourable business environment. The innovation activity in Croatia has been in line with peer countries, measured by new patents. (Moore–Vamvakidis 2007) According to the

comparison between potential and actual non-privatisation FDI at the end of 2003, (Demekas et al. 2005) Croatia was among the countries that could gain the most in terms of additional FDI.

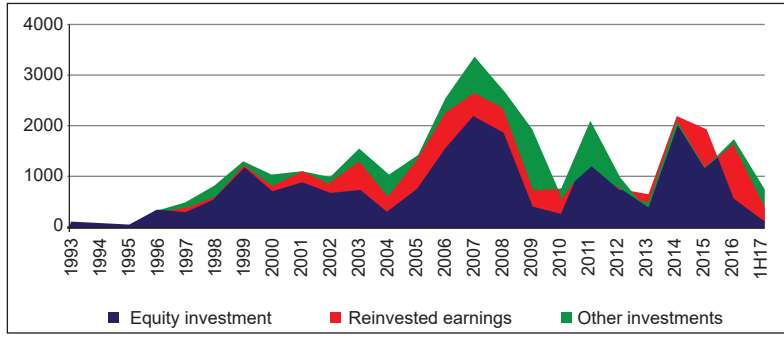

Figure 7.
FDI in Croatia (Million EUR)
Source: White Book 2017, based on HNB s. a. statistics.

Most of the foreign investments took place in the service sector during 1993–2007, and the largest beneficiary of the inward FDI has been the financial sector, reflecting bank privatisation and capital injections to foreign-owned banks. (Moore–Vamvakidis 2007) Foreign ownership in the banking sector was over 90% in 2014. On the other hand, FDI had less impact on manufacturing in Croatia. Due to the drop in the real estate sector, investment had been very low from 2008. After the crisis, investments gained in recovery momentum in 2015, increasing by 4.6% in 2016. The expected materialisation of newly announced publicly-funded projects together with a greater efficiency in attracting and absorbing EU funds give cause for optimism regarding the mid-term investment outlook. (EIZ 2017) The biggest FDI investments make up for almost one half of total FDI inflows: Telekom (having a dominant position in both land and mobile networks), the biggest banks (holding more than 55% of the banking market), and the oil company (having MOL and the Republic of Croatia as its biggest shareholders) (Figure 8). The financial industry accumulated the largest amount of FDI investments until Q3 in 2017. The amount of the FDI was 9.5 billion euro, that was almost a third of the total accumulated investments in Croatia (32 billion euro). The financial industry is followed by wholesale trade, with 2.8 billion euro investments. (*White Book* 2017)

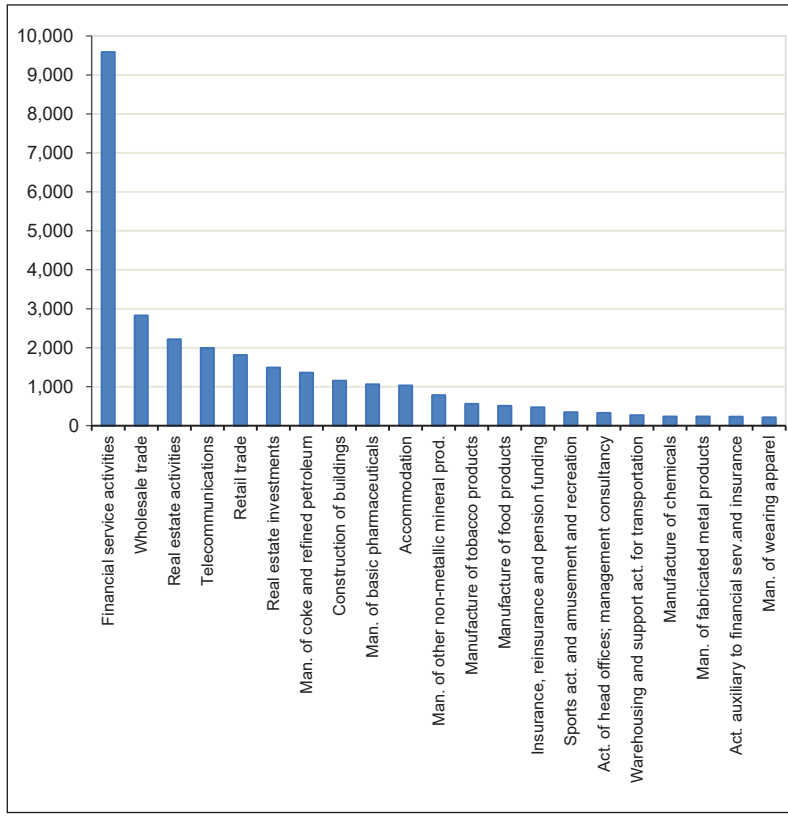

Figure 8.

FDI in Croatia by industry (net incurrence of liabilities), top 20 industries, in Million EUR, 1993–2017Q3

Source: HNB s. a.

In most CEE economies, early EU accession had a significant impact in shaping the scale and the nature of the FDI. EU membership ushered in sizeable foreign direct investments which underpinned their progressive integration in global value chains, especially in the automotive industry. (Orsini 2017) During the 1990s, the low level of FDI was interconnected with the underperformance of the export. The lack of trade associations with EU and CEFTA, i.e. less advantageous trade relations with the European

market made Croatia less attractive in the eyes of foreign investors. As a result, the FDI's positive impact on export performance was also missing. (Šonje–Vujčić 1999) Many Croatian companies that were internationally competitive in the early 1990s have lost their markets, because firms from other transformation countries have restructured faster, often with the contribution of foreign investors. Croatian firms have shown relatively low level of internationalisation. Despite sizeable FDI in the 2000s, it bypassed the export-oriented sectors, contrary to the trend in Central and Eastern Europe where FDI had contributed significantly to export restructuring. While most CEE countries also succeeded in increasing exports mainly in higher-end technology sectors, Croatia mostly specialised in exporting lower-end technology products. (EC 2015) Although the Croatian manufacturing sector confirms that companies that have received FDI are more successful regarding their capital, sales, employment and productivity growth (compared to domestically owned ones), FDI failed to increase the employment rate, exports, productivity or competitiveness of the economy significantly. Retained profit and flows into and from mother companies make up for 15–15% out of the total FDI inflows. However, retained profit recorded a strong decline in 2015, as large banks did not pay out dividends after they recorded strong losses due to conversion of CHF loans. (White Book 2017)

Concerning the origin of FDI, the EU has been the largest investor in Croatia (Figure 9). Since 1993, the share of the EU15 has grown constantly until the crisis of 2008. Based on the inward stock in 2012, the top three investment partners were Austria, Germany and Hungary. On the other hand, the most important destination countries of Croatian outward stock FDI were Slovenia, Bosnia and Herzegovina and Serbia by 2012. (UNCTAD[10] 2014) In 2017, the top three investment partners were the Netherlands, Austria and Italy. At the same time, the most important destination countries of Croatian outward FDI (net acquisition of financial assets) were the Netherlands, Bosnia and Herzegovina and Slovenia in Q1 of 2017.

[10] UNCTAD: United Nations Conference on Trade and Development.

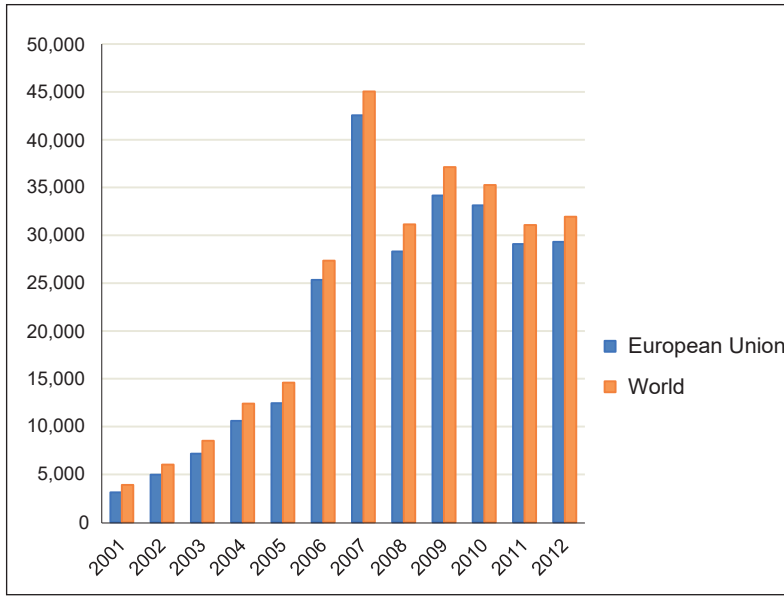

Figure 9.
FDI stock in Croatia, by geographical origin, Million USD
Source: UNCTAD 2014

Together with its geo-strategic location and high quality of road infrastructure (the 10th best according to EU transport scoreboard 2016), Croatia's attractiveness has certainly developed with the EU accession. Besides all the already mentioned obstacles, an improving business environment (Table 2) emerges since the EU entry.

Table 2.
Doing business in Croatia, measured in DTF (distance to frontier)[11]

Year	Overall DTF
2017	72.99
2016	72.78
2015	72.20
2014	63.79
2013	62.65
2012	62.98
2011	61.76
2010	61.33

Source: Doing Business s. a.

Research by Bezić et al. (2011) indicates that the Croatian manufacturing industry is characterised by a lack of comparative advantages. Weak export competitiveness emerged mainly because of insufficient investment in production which could speed up the adjustment of the Croatian manufacturing industry to the competitive conditions at the international market. This weakened connection results also in reduced innovating competences of the companies. Aprahamian and Correa (2015, 1) see the fundamental problem in the failure of renewal and transformation of the manufacturing base, linked to low rates of firm entry and exit. Annual entry rates were only 5.5%, compared to 9–18% for peers, while annual exit rates were 6.5%, against 7–26% for peers in the examined period. Transition to a market economy is usually characterised by much more firm entry than firm exit. Croatia, where exits outpace entries, show a picture of a country with a stagnant economy and little creative destruction or innovation—hence limited export diversification. Another marker of economic stagnation is the inadequate levels of R&D by enterprises. Business enterprise R&D (BERD) in Croatia is among the lowest in the member states and much lower than the EU28 average (Figure 10).

[11] An economy's distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier. For example, a score of 75 in 2016 means an economy was 25 percentage points away from the frontier constructed from the best performances across all economies and across time. A score of 80 in 2017 would indicate the economy is improving.

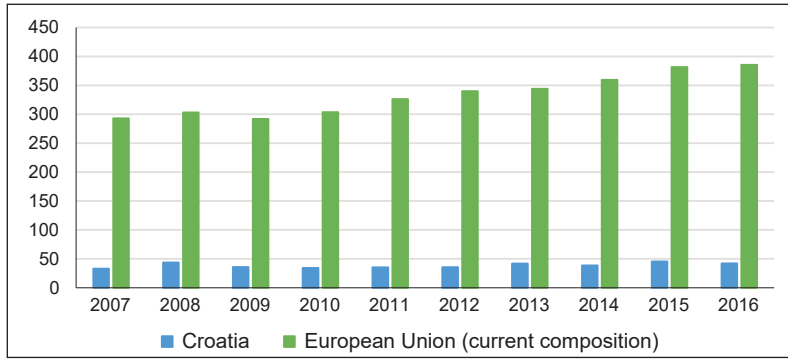

Figure 10.
Business expenditure on R&D (BERD), EUR per inhabitant
Source: Eurostat s. a.

The Use of EU Funds

In 1995, the EU started a negotiation about a cooperation agreement with Croatia and the country's involvement into the PHARE program. However, the negotiations were suspended in the same year following the military offensives in Krajina. Later, the cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY) became a key factor in the EU–Croatia relations, first stated in the Regional Approach in 1997. It would have been the condition to join the PHARE program and to negotiate a cooperation agreement but the condition was never fulfilled. Until November 1999, Croatia was excluded from the PHARE because of its failure to strengthen its democratic institutions (e.g. reforming the electoral law, decentralising the media, respect for minorities and the return of refugees). The outage from the PHARE did not only mean financial losses for Croatia but also reduced possibilities of participation in international projects and experience exchange. (Samardžija et al. 2000) At the same time from 1991–1999, the EU provided 349 million euro to Croatia for reconstruction in the framework of the Obnova program, humanitarian aid in the framework of ECHO. (EP 2001) The new financial instrument was adopted in December 2000, to support the participation of the countries in the Stabilization and Association Process (SAP). The Community Assistance for Reconstruction, Development and Stabilisation (CARDS) program announced 4.6 billion euro for the region in the period of 2000–2006. The development

of the SAP has been monitored in stabilisation and association reports. Between 2001 and 2004, in the framework of CARDS National Program in Croatia, the country received 260 million euro. Within the CARDS, most of the projects were financed entirely by EU funds without the requirement for co-financing, except for small scale grants where final beneficiaries had to ensure co-financing of 20%.

Following the decision of the European Council of 17–18 June 2004, Croatia became a candidate country, which also created a basis for utilisation of pre-accession funds (PHARE, ISPA and SAPARD) to enhance important political, economic, social and institutional reforms. Compared to the CARDS program, the pre-accession funds were substantially larger and focused on financially bigger projects with obligatory co-financing from the side of the beneficiary. From 1 January 2007, pre-accession funds underwent a significant policy reform. The Instrument for Pre-Accession Assistance (IPA) was set up to facilitate the entry of the candidate countries into the European Union. The program in Croatia replaced the CARDS, PHARE, ISPA and SAPARD. Croatia got access to all 5 IPA components[12] and received accreditation to manage the funding itself under the Decentralised Implementation System. Through 2007–2013, Croatia received more than 900 million euro. The IPA assistance focused on institution building, supporting alignment with EU law, the preparation to use EU structural and cohesion funds and promoting economic and social development (Table 3).

Table 3.

EU assistance to Croatia through various programs, 1991–2013, million EUR

	1991–1995	**1996–2000**	**2001–2006**	**2007–2010**	**2011–2013**
Humanitarian aid (ECHO)	243.2	50.6	N/A	N/A	N/A
OBNOVA	N/A	59.1	N/A	N/A	N/A
CARDS	N/A	N/A	260.0	N/A	N/A
PHARE	N/A	N/A	160.0	N/A	N/A
ISPA	N/A	N/A	60.0	N/A	N/A
SAPARD	N/A	N/A	25.0	N/A	N/A
IPA	N/A	N/A	N/A	474.1	430.0

Sources: Novota et al. 2009, 13; Antonopoulos–Bachtler 2014, 190; EC 2011, 10.

[12] Transition Assistance and Institution Building, Cross Border Cooperation, Regional Development, Human Resource Development, Rural Development.

The initial political and administrative conditions were not in favour of effective pre-accession assistance coordination in Croatia. Weak performance in terms of inter-ministerial coordination was stressed by assessment reports of the European Commission but also academics and employees in the EU assistance field. From 2004, every government ministry had a European Coordinator and many had established European coordination departments but policy coordination continued to suffer from lack of an overarching body for policy supervision of planning, and decision-making remained politicised and fragmented. (EC 2004; 2005) The State Administration Reform Strategy was launched in 2008 aiming to enable the transition to the principles and practice of good governance in line with the best European standards to improve coordination among other measures. (Kandžija et al. 2011) The Central Office for Development Strategy and Coordination of EU Funds (CODEF) was designated to be responsible for the overall coordination over preparation and monitoring of the IPA programme implementation. Pre-accession assistance was seen as the main driver for inter-institutional coordination in Croatia. Antonopoulos and Bachtler (2014) found mainly positive the CARDS and IPA influence on administrative capacities for coordination. At the same time, they highlighted the importance of three domestic constraints in Croatia: the limited synergies between EU and national policies and value-addition; considerations of political cost; and allocation of responsibilities. Lessons learned from the EU10 reveals that the path of Croatian structures differs from many Central and Eastern European countries, and there are more similarities with countries like Bulgaria and Romania, as regards the instability and incomplete state of structures, and the preferred type of institutional structures to receive financial assistance.

In 2013 the transition from the IPA to the Structural and Cohesion Funding was challenging for Croatia, not to mention the preparations for the new financial period of 2014–2020. Soon after the accession, the National Strategic Reference Framework was approved by the European Commission, which covered half a year until the end of the 2007–2013 financial period. With the beginning of 2014–2020, Croatia became the beneficiary of the European Structural and Investment Funds (ESIF). The Partnership Agreement for Croatia was adopted in October 2014, setting up the priorities for 2014–2020. (Lenardić 2016) With the accession, the allocation of funds has increased significantly. Through 4 national programs, Croatia benefits 10.7 billion euro from the ESIF over the period 2014–2020. This represents

an average of 2,526 euro per person from the EU budget. At the beginning of 2018, 12% of the 10.7 billion was absorbed (Table 4).

Table 4.
Total EU payments, cumulated to the end of each year, million euro, as of 9 March 2018

	2015	**2016**	**2017**	**2018**
Initial pre-financing	223	326	326	326
Annual pre-financing	0	164	215	215
Interim pre-financing	54	194	611	780
Total EU Payments	278	684	1,152	1,322
Percentage of the total (10.7 billion)	3%	6%	11%	12%

Source: Cohesiondata 2018

Beyond institutional matters, the ability of co-financing is also crucial. In 2012, Harris and Hahn warned about the need to create fiscal space to co-finance a six-fold increase in EU funding: right before the accession, Croatia lacked the fiscal space to co-finance EU funded projects. Considering the 2007–2013 period, 77% of available funding from the ERDF, 65% of the ESF and 95% of the Cohesion Fund was absorbed by Croatia, which means 81% average rate and which was the lowest rate in the EU, but Croatia was the only newcomer as well. (Cohesiondata 2018)

Croatia's operating budgetary balance started with 173.4 million in 2014 and improved to 226.7 million euro in 2015 (Table 5). However, 0.52% of GNI as operating budgetary balance is the worst number among peer countries (Figure 11). The Croatian Chamber of Commerce (Hrvatska Gospodarska Komorna, HGK) reported that during the first three and a half years Croatia has absorbed 19% of the funds available to it (a little under 2 billion euro). According to their calculations, Croatia absorbed twice as much in 2016 as in 2015. The weaker absorption capacity right after the accession was mainly due to a high number of uneven project proposals, lack of staff in relevant bodies and frequent tender documentation changes. With an improvement in the number of the tenders, stronger administrative capacities in EU fund management, and the financial sector's openness to back applicants, Croatia could take more advantage of EU funding in 2016. (EBL 2017) In April 2017, Prime Minister Andrej Plenković said that the money available to Croatia in EU funds represents "an obligation, a challenge and a task" to absorb and use these funds for specific projects. (Vlada 2017)

Table 5.
Operating budgetary balance of Croatia

	2013	2014	2015	2016
Gross National Income (GNI), EUR million	42,732.2	41,772.8	43,596.5	43,988.0
Operating budgetary balance (EUR million)	+49.6	+173.4	+226.7	+529.5
Operating budgetary balance (% GNI)	+0.12%	+0.42%	+0.52%	+1.20%

Source: EC s. a.

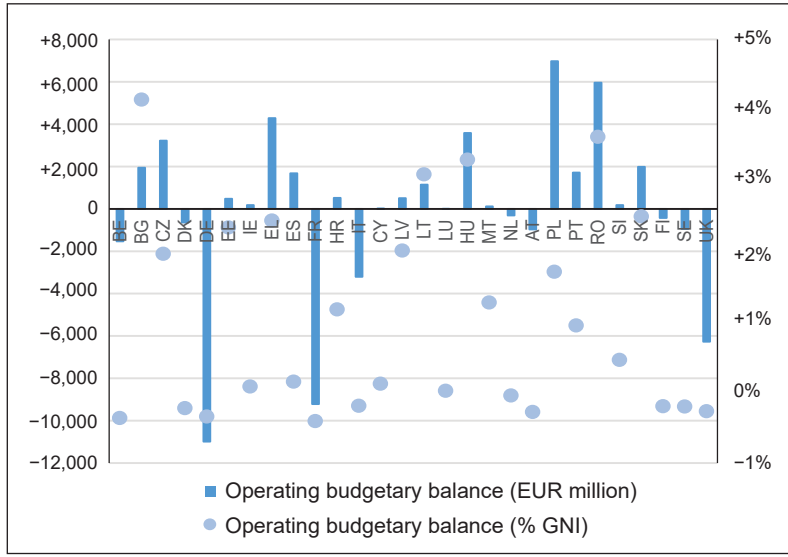

Figure 11.
Operating budgetary balance by member states, 2016

Source: EC s. a.

The Socioeconomic Effects of Integration

Yugoslavia was relatively open compared to other socialist economies in terms of free movement of persons. The 1965, reforms opened the borders for people and a mass guest-worker migration started to the West. It reached its

peak in 1973 when 1.1 million workers were abroad, most people left Croatia. (World Bank 1983) During the 1990s, the Yugoslav war had remarkable socioeconomic impacts (Figure 12). The heaviest fights occurred in the second half of 1991, resulting in waves of large-scale forced migration. Altogether between 1991 and 1995, the conflicts in Croatia led to an outflow of refugees, most of whom were ethnic Serbs. In the post-conflict period (1996–2000) ethnic Croats returned in significant numbers to territories reintegrated under Croatian government control, both from abroad and from other parts of Croatia, whilst the exodus of ethnic Serbs tended to continue. The return of Croatian Serbs came to the political agenda after 2000, when Croatia's commitment to this became a key test of progress on accession to the European Union. (Mežnarić–Stubbs 2012) Thus, contrary to other member states of Central and Eastern Europe, Croatia has a more diverse pattern of migration which has been characterised by not only a high but almost stagnant number of traditional labour migrants but also the return of refugees who left the country because of the war. Migration flows during the 1990s but also the 2000s were politically motivated to some extent. The bulk of immigration came from Bosnia and Herzegovina, while most of the emigrants went to Serbia and Montenegro, followed by Bosnia and Herzegovina. During the period 2000–2007 among the Southeast European countries, Albania reported the highest share (nearly 28%) living in the EU15, followed by Bosnia and Herzegovina, Macedonia and Croatia. Over that period 300 thousand Croatian citizens, accounting for about 7% of the Croatian population, were living in the EU15, most of them in Germany and Austria. After its accession, Slovenia introduced quotas for workers from non-EU member states and the number of Croatian workers (mostly commuters) reduced compared to the pre-accession period. (Vidović 2007) Thus there are two recent trends in terms of emigration from Croatia. The one is regional, to the direction of the Yugoslav successor states, particularly Serbia and to a decreasing extent, Bosnia and Herzegovina. This migration is often based on national and ethnic identification and family ties but also includes a degree of labour market migration. The second is to the European Union, Germany in the first place and Austria in the second (Figure 13). The largest motive of this migration is labour migration either directly or indirectly. (Mežnarić–Stubbs 2012)

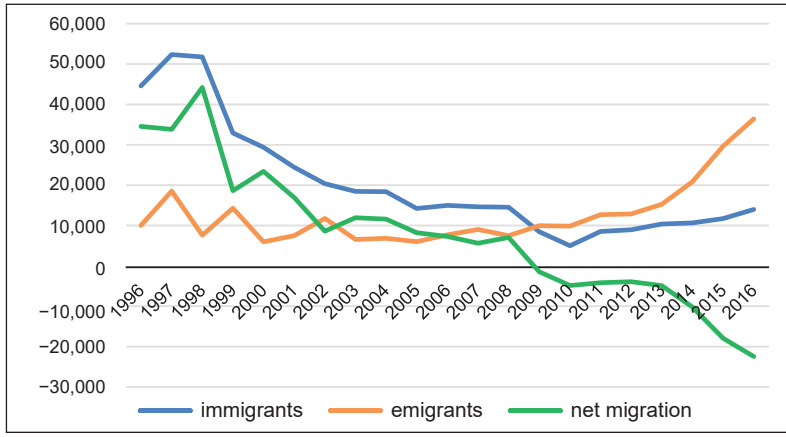

Figure 12.
International migration of the population of Croatia, 1996–2016
Source: DZS s. a.

All in all, throughout the 1990s and most of the first decade of the 2000s, Croatia was a country of net immigration, mainly of citizens from other parts of the former Yugoslavia. This trend turned over in 2009 and 2010 when figures showed a 40% reduction in the number of immigrants to Croatia, which may be related to the impacts of the global economic and financial crisis. The crisis resulted in a significant reduction in the demand for foreign labour in the building, construction and service sectors. (Mežnarić–Stubbs 2012) The negative net migration trend has become particularly pronounced with Croatia's accession to the European Union in 2013. Since joining the EU, the country has experienced significant levels of emigration, particularly of people of prime working age. However, Stubbs and Zrinščak (2017) warn that official statistics significantly underestimate the extent of emigration. Higher figures are usually based on figures from the statistical offices of destination countries. For example, based on DEStatis[13] data, between 2014 and 2015, Germany alone had an increase of 34,548 registered foreigners with Croatian citizenship, while the Croatian Bureau of Statistics suggested that some 12,325 Croatian citizens emigrated to Germany.

[13] DEStatis: Statistisches Bundesamt (en – Federal Statistical Office in Germany).

It is important to note that Croatia did not enter the labour market of the EU without any restrictions. The provisions concerning the movement of the labour force include a 2 + 3 + 2 arrangement. Thirteen member states (including Austria, Germany, Italy and Slovenia) applied restrictions during the first phase (1 July 2013 – 30 June 2015). Among others, Austria and Slovenia maintain restrictions during the second phase (1 July 2015 – 30 June 2018). In the third phase (1 July 2018 – 30 June 2020) member states will be able to apply the restrictions only in case of serious disturbances of their labour market or a threat of such disturbances. According to Župarić-Iljić (2016), these temporary restrictions have not hindered the emigration of workers. Beyond economic or education-driven migration, Croatian citizens increasingly migrate to reunite their family with Croatian people who have already worked the EU.

We may have two conclusions. First, the traditional destinations such as Germany, Austria and Italy, which have attracted previous generations of Croatian emigrants, still remain the most relevant target countries. Second, data compared before and after EU entry are indicative of the ongoing trend of increased emigration.

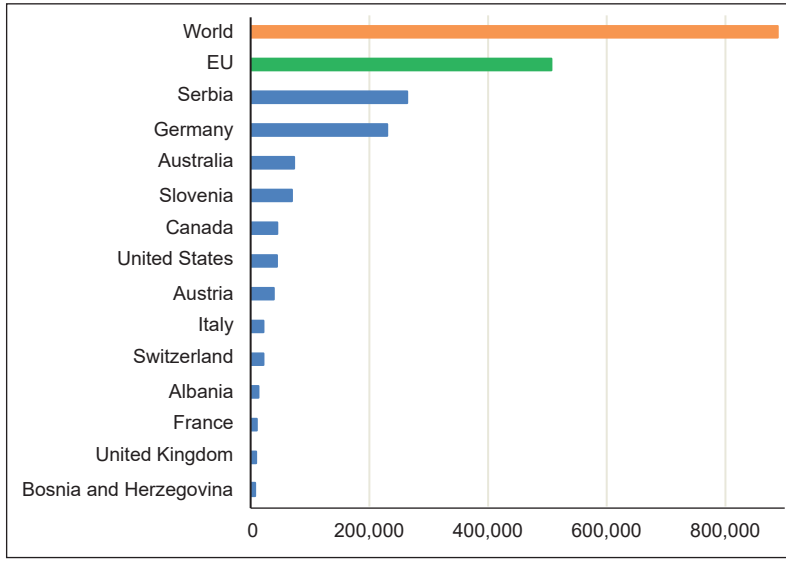

Figure 13.

Estimates of emigration from Croatia, stocks in 2013, by destination countries

Source: WB 2017

Inward remittance flows were estimated at 2,190 million U.S. dollars in 2016 (Figure 14). Whilst relatively low by regional standards as a proportion of GDP, Croatia's remittances represent about 30% of FDI inflows. (Mežnarić–Stubbs 2012) Gligorov (2004) argues that remittances of Croatian citizens working abroad (together with the revenues from the tourism sector) have helped to maintain the possibility of policymaking towards vested interest. As a result, it has not enforced any radical structural changes.

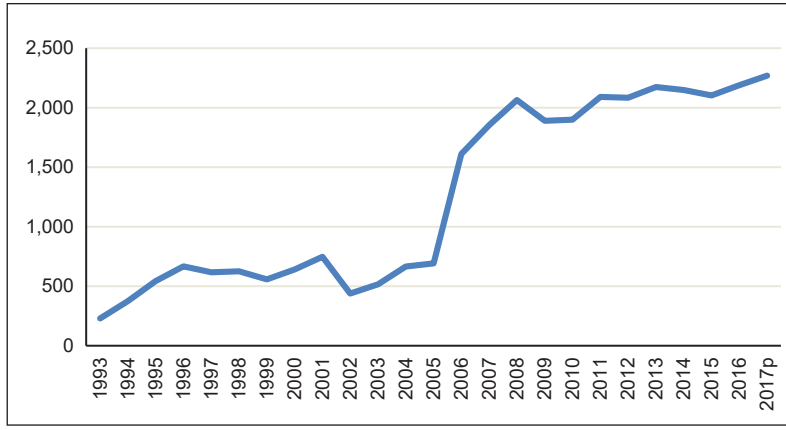

Figure 14.
Migrant remittance inflows, million USD

Source: WB 2017

Brain drain is an important issue not only for Croatia but for the entire Central and Eastern Europe. Croatia is reportedly a country with a high emigration rate among the highly educated. However, due to statistical shortcomings, it is difficult to draw clear conclusions regarding the educational and occupational profile of Croatian emigrants. (Župarić-Iljić 2016) According to the available data, some 50% of emigrants had completed secondary education and around 8% higher education in 2015. According to the Croatian Association of Hospital Physicians, there has been significant emigration of healthcare professionals: with estimates that 525 medical doctors left Croatia between 2013 and 2016. (Stubbs–Zrinščak 2017) The results of Sundać and Stumpf (2016) suggest that brain drain caused by dissatisfaction in the home country greatly affected the competitiveness of Croatia, diminishing its global competitiveness ranking. Emigration,

together with a natural decrease of population, contributes to a significant population decline in Croatia and a rapidly ageing population.

Conclusion and Outlook: Drawing the Balance of the Results of Integration

Deciding whether the EU served as an anchor during the transformation process of the post-communist countries means whether the EU was able to be the point of reference and to catalyse the process of changes. As Harrold and Hahm (2012) note, Europe has invented a "convergence machine". The machine functions so, that the EU welcomes poor countries and helps them to become high-income economies, the authors claim. The question is whether it works with every country since the "Convergence Machine" is certainly an opportunity but not a guarantee. Győrffy (2008) shows that the EU is powerless even regarding its own member states when the requirements do not reflect the domestic political and social convictions, but they appear only as external expectations instead.

There is certain evidence that in case of Central and Eastern European countries the EU served as an anchor during their transformation process.[14] Croatia could have joined this group of countries and might have been a frontrunner in Europeanisation based on the country's identity, historical and cultural heritage. As a consequence of certain conditions (most of all the Yugoslav war in which Croatia was involved from the very beginning of its transformation process) Croatia did not get into the group of Central and Eastern European countries as Slovenia. Croatia has experienced a detour from the "mainstream Europeanisation path", it became a late-comer candidate, a special case, and meanwhile, the attitude of the EU and the dynamics of Europeanisation have also changed. In case of Western Balkan countries, the role of the EU as an anchor has become weaker mainly because of the lack of a clear promise of membership. When the accession negotiations with Croatia went on after 2008, the prospects for the future were very different in Europe. It was not the transition process any more that needed to be anchored. Instead, it turned to recovery from the crisis. (Sigér 2018)

[14] See e.g. Csaba 2004.

In their opinion article, Harrold and Hahm (2012) collected Croatia's strengths and weaknesses compared to four new member states' (Slovakia, the Czech Republic, Slovenia and Estonia) position in the European Union. Among the strengths we find trade, "the first leg of the convergence machine". The evidence shows that just like the peer countries, Croatia definitely benefits from the trade integration with the EU. The other strength is financial integration, "the second leg of the convergence machine". The authors claim that Croatia benefits from capital flows from EU members. At the same time, Croatia faces several weaknesses that may hamper the fulfilment of potential benefits of the EU membership: the poor climate for private enterprises, the limited support for research and development, and innovation, the low level of labour productivity and employment, and the too-large government. As the Commission highlights, restrained growth, delayed the restructuring of firms and the limited performance of employment have common roots: inefficiencies in the allocation of resources. The unfavourable business environment is a major obstacle in the adjustment capacity of the economy. (EC 2015)

The "convergence machine" has also changed, and the dynamics of the 2004/2007 enlargement cannot be repeated. These days the EU model is not working as it worked at the very beginning of the new millennium since the EU finds itself in a stalemate in its response to new challenges. Öniş and Kutlay (2017) write about limits of the EU's transformative power in the European periphery, regarding both internal (member) and external (not member) countries. In case of Croatia, we only see a feeble anchor capacity. Take a look back onto the integration process of Croatia, we see a twofold phenomenon: Croatia wanted less from the EU (from both material and mental incentives it offered in return for political and economic conditionality) and as times have changed, the EU wanted and was able to give less as well. The fact that the country arrived to the EU alone, may limit its ability to enforce its interest. Since the EU prefers group enlargement, a single entry has not happened since 1981. Croatia arrived as a lonely newcomer among the old Southeastern Europe (SEE) or CEE countries, including Slovenia, its ex-Yugoslav peer, with whom its relationship is far from being unclouded. In many indicators, Croatia lags behind all the other member states. The question is whether the EU's active leverage has diminished after the accession. Croatian National Bank Governor Boris Vujčić said in January 2017 that Croatia is planning to introduce the euro. We need to meet the Maastricht criteria and we are on the right track – he said. (Sigér 2018)

The convergence process could be a strong anchor for further reforms and after the recovery from the long recession, it could be a determinant priority of Croatian policymaking. Most probably those researches are right, which state that the EU is an opportunity for Croatia but not a guarantee. The opportunity offered an anchor for economic restructuring and catching up, complemented with financial support, as well. If these opportunities remain unutilised, and the losers of the EU accession stay uncompensated, the disappointment with the membership is inevitable. Although it is clear that there will not be a further enlargement soon, a credible enlargement perspective for the Western Balkans must be maintained, as EC President Juncker stated in his State of the Union 2017 speech. Croatia can set a good example for this region which may contribute to the long term stability of the Western Balkans as well.

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Chapter 3.

Economic Integration and Interdependence in the Czech Republic

At the Heart of Europe: The Czech Republic and Economic Integration with the EU

Christopher A. Hartwell

Introduction

Situated at the heart of Europe, Czechs are fond of noting that Prague is further west than Vienna. This geographic fact has been mirrored in the policies of the post-communist Czech Republic, policies which have had been consistently oriented towards European integration and towards the EU in particular. The results of these policies, enabled by the approach the Czech Republic took at the beginning of its transformation, have been remarkable: since 1989 (the beginning of the transformation) and accelerating since 1993 (the Velvet Divorce with the Slovak Republic), the country has undergone an impressive economic restructuring, embedding itself in regional and global value chains, seeing a constant increase in living standards (Figure 1), and placing itself firmly at the centre of European integration efforts. While the country has suffered setbacks and crises (1998 and 2008 as the major shocks experienced by the Republic), the Czech Republic has benefitted greatly from its move to the west. By any metric, the Czech Republic's transformation from communism to capitalism, and from a Russian dependency to a vibrant market economy at the heart of Europe, has been a success.

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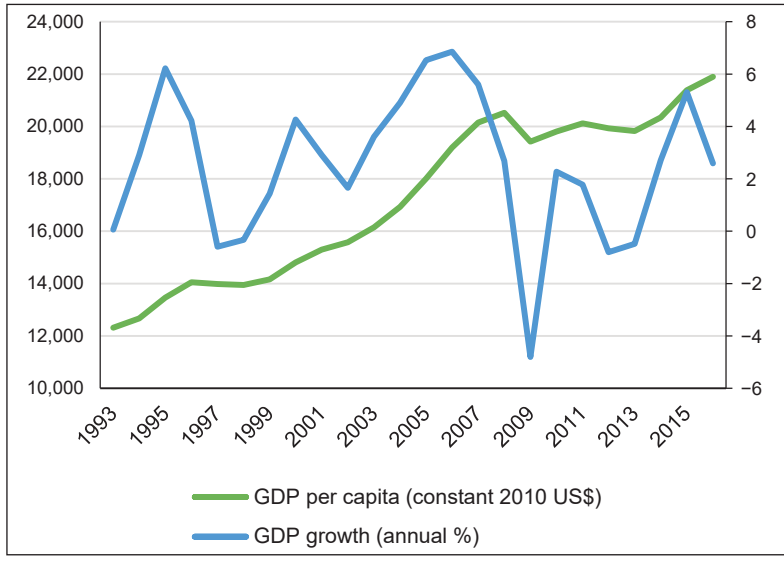

Figure 1.
Growth in the Czech Republic

Source: WB[1] s. a.

The road to this success has not been easy, however, and appears to be more fragile from the vantage point of 2018 than in years past. While the first post-communist governments were able to implement wide-reaching macroeconomic and institutional reforms, the country has remained plagued by some forms of institutional malaise and issues such as corruption and a business environment which should be far easier. Moreover, despite being a champion of European integration, Czechs are also uniformly against adopting the euro and have remained a thorn in the side of France and Germany in their drive to harmonise EU institutions with euro area ones. Also, like their Polish neighbours, a strain of populism has recently emerged in Czech politics, bringing some measure of Euroscepticism and promises by incoming Prime Minister Andrej Babiš for reform of the overall legislative and institutional environment.

[1] WB: The World Bank.

This chapter examines the economic development and integration of the Czech Republic with the EU via an institutional lens, tracing out the changes in major economic and political institutions in the country over 1989–2016 and how they contributed to economic success in the country. In particular, the chapter examines the shifting role of Czech politics, property rights and trade, and how these fundamental economic mechanisms evolved both towards and after EU accession. Additionally, I also show how the process of integration itself has impacted the institutional development of the country, influencing policymakers in favour of some market-supporting institutions and away from others. Using this framework as a basis, I also show the changing nature of investment (both foreign and domestic) in the country, trends in labour and demography, and an overall appraisal of the process of European integration on the Republic in the recent past and for the near future.

The result of this analysis is that the Czech Republic remains at the heart of Europe in many ways, and European integration has aided its post-communist transformation. However, the Czech Republic has remained aloof on some aspects of institutional change and has gone against European trends in others, leaving its economy still needing to overcome periodic bouts of structural inaction to fully reap the benefits of integration. Recent political trends do not bode well for these fundamental economic institutions, as the populist wave in Central and Eastern Europe is, at its heart, inimical to appropriate market-supporting institutional reforms. Succumbing to the siren song of populism may, in turn, harm the country's economic growth in the long run as well as lead to some institutional de-coupling with the European Union. While the Czech Republic remains an economic success story, it appears that the achievements of the past quarter-century are still in many ways not assured, especially with regard to its economic integration with Europe.

The Start of Economic Integration

The transition of then-communist Czechoslovakia into the free-market Czech Republic is one of the better-known and rightly celebrated success stories of the transformation in Central and Eastern Europe. With the fall of communism and the removal of the communist regime in 1989, the Czechoslovak Federal Republic (CSFR) undertook an ambitious and far-reaching

set of reforms to bring the economy from plan to market. This program has been amply documented elsewhere (see especially Svejnar [1995] for a comprehensive early assessment) and need not be revisited here; suffice it to say, authorities in Prague following restrictive fiscal and monetary policies to break the back of inflationary pressures (including the institution of a fixed exchange rate) while undertaking broad structural reforms such as voucher privatisation and a phased elimination of the state's monopoly on foreign trade. (Hanel 1992) By 1992, a nascent economic recovery could be seen as the pace of economic decline slowed, foreign trade began to reorient away from the former Council for Mutual Economic Assistance (CMEA or COMECON) countries, and unemployment started to fall. Across the board, macroeconomic stabilisation resulted in an improvement in economic and social conditions in the country, albeit from a fairly low base (Table 1).

A key tenet of the reforms undertaken by the government of democratically-elected Prime Minister Petr Pithart (and driven heavily, if not exclusively, by Finance Minister Vaclav Klaus) was an explicit focus on achieving European integration, including (but not limited to) membership in the European Union. Relations with the then-EC were incredibly poor in the late communist period, as even the conclusion of a trade agreement in 1988 fell far short of similar agreements with Poland and Hungary; perhaps more obviously, the EC's PHARE program, set up to provide technical assistance to Central and Eastern Europe (CEE) countries transitioning from communism, pointedly excluded the CSFR in 1989. (Hanley 2002) Despite these rocky beginnings, negotiations with the EU began in December 1990 (at the same time as they did between Poland, Hungary and the EU) resulting in the CSFR's inclusion in PHARE and, more importantly, a Europe Agreement in December 1991 (which formed the legal basis and structure for eventual EU accession—a revised Agreement was signed in December 1993 after the break-up of the CSFR). By 1997, the Czech Republic (along with former countrymates Slovakia and fellow transition countries Poland and Hungary) were invited to start negotiations for membership, focused on the steps necessary in each country to ensure compliance with the adoption of the *acquis communautaire.* (Staehr 2011)

Table 1.
Economic and Social Conditions in Czechoslovakia, 1990
(Cross-National Time-Series data set)

Index numbers	**1990**
GDP per capita, constant US 1990 dollars	3,100
Human Development Index	0.761
Number of cars per 1,000 people	206
Maximum decline in GDP during the transition	–21.10%
Women as % of the labour force	44.30%
Inflation, annual % change	10.80%
Unemployment rate (1991, %)	6.60%
Net FDI (US$ millions)	207

Source: Hardt–Kaufman 1995

To achieve the overarching goal of European integration, a goal supported (after a brief interlude) by all political actors in the country, (Baun et al. 2006) nearly every reform which was undertaken in Czechoslovakia and then the Czech Republic was oriented towards European models and institutions. Starting from the push for macroeconomic stabilisation to the broader structural and political reforms taken in subsequent waves in the country, "the process of institutional alignment with the requirements of the acquis served as a basis for domestic transition in [Central and Eastern European] countries towards a market-based economy". (Kaminski 2001, 7.) However, this did not mean that the EU served as the only vehicle for economic integration, as the Czechs pursued a multi-pronged strategy that involved enmeshing the country in various international organisations such as the OECD and the General Agreement on Tariffs and Trade (GATT) as well as pursuing EU accession. (Hanley 2002) As Haughton (2007, 236) noted, "the key motivation of the trail-blazing marketizers in the early 1990s in CEE such as […] Václav Klaus in Czechoslovakia/Czech Republic […] [was his] ideological beliefs and wish to replicate certain Western economic models, rather than a more specific desire to prepare for membership of the European club".

Regardless of the initial divergence between the Czechs' desire for European integration and the more haphazard approach to EU accession pursued in the 1990s, as EU accession came closer and more chapters of the *acquis* were closed, Czech politicians became more "Europeanised" than

they had initially been. (Baun et al. 2006) And from a practical standpoint, there was already a substantial amount of overlap in terms of the institutional structures pursued by Czech authorities as part of their desire to move West. A prominent example was the drive for the development of private property rights in the Czech Republic, moving away from the socialist communal property system to one favouring and protecting individual rights. In 1989, Czechoslovakia had one of the smallest private sectors across transition economies, "employing only about 1.2% of the labour force and producing a negligible fraction of national output". (Kočenda 1999, 6.) Despite not having the same advantages as, say, Poland, (Hartwell 2016) "the Czech authorities have consistently pursued policies to create the market institutions supporting the effectiveness of modern property rights". (Rapaczynski 1996, 100.)

Two major reforms supported this move towards property rights: first, the development of a legal framework and independent judiciary to enforce said rights along EU best practice, and second, the institution of a mass privatisation scheme to remove ownership of state-owned enterprises from the government and transfer it to a decentralised mass of private investors. With regard to the reforms towards property rights, EU accession and the adoption of a rules-based regime such as the *acquis* made a significant difference in enshrining the principle of private property into Czech law. This was complicated in the Czech case (as elsewhere in transition) by the communist takeover of the 1940s, which expropriated private property and put it in service of the state; understanding these historical property rights became both a necessity for protecting rights going forward and creating a viable land administration system sufficient for EU entry. (Bogaerts et al. 2002) This does not mean that the approach was non-controversial: as Appel (1994, 22) wrote: "While the establishment of a liberal economic system constitutes the end goal of Czech privatization, the present government's means of achieving this goal diverge from liberal economic logic and prevailing property rights theories. In addition to economic considerations, moral and political imperatives drive the process of redefining property rights in the Czech Republic. Thus, contrary to dominant theories of property rights, a particular notion of corrective justice not only legitimates new Czech property rights but inspires their creation as well." But with restitution for previous claims a key part of the development of the property rights regime in the country from a political and moral standpoint, the Czech authorities worked hard to balance the possible delays or re-expropriations needed to

redress previous injustice with the benefits of creating a rules-based rights regime of EU quality. (Karadjova 2004)

The issue of restitution also became intimately entwined with the second issue, that of privatisation, where sometimes conflicting claims to assets arose. As amply detailed elsewhere, (Brada 1996) the Czech Republic underwent voucher privatisation to sell off state "assets" as quickly as possible. While, in the land sphere, this resulted in some ludicrous results,[2] on the whole, this approach was successful, especially in privatising small and medium-sized businesses. (Brada 1996) Similarly, Gupta et al. (2008) found that the firms which were privatised relatively quickly also ended up being more profitable than those which remained in the government's hands; other firms, which had a "strategic" angle, saw their privatisation delayed, and it took EU intervention and the prospect of delaying accession to finally force privatisation.[3]

Similarly to its economic growth path, the reforms in property rights had a substantial measure of success, especially given the low level of such rights informally pre-transition. As Figure 2 shows, using the International Country Risk Guide's (ICRG) "investment profile" measure (a commonly-used metric for property rights), the country saw constant improvement throughout the 1990s and early 2000s in its perceived protection of these rights, peaking at the highest-ranking available just before accession in 2004. After accession, as we will see, property rights protection did erode somewhat, following a general pattern in Europe after the global financial crisis and (especially) after the Eurozone sovereign debt debacle. (Hartwell 2013) However, even with this erosion, typical of a middle-income country, the Czech Republic had made impressive progress in such a short amount of time. This can also be seen in the share of GDP dedicated to the private sector which, starting from a very low 10% in 1990 (the lowest amongst all transition economies in Central and Eastern Europe), reached 80% by the time of EU accession, equalled only by Slovakia and Estonia. (Estrin et al. 2009)

[2] Bogaerts et al. (2002) detail how privatisation of some land parcels in Czechoslovakia resulted in each owner receiving the equivalent of a sheet of A4 paper's worth of land.

[3] The steel sector in the Czech Republic was the key sector in which EU intervention was instrumental for privatisation, see Sznajder (2006).

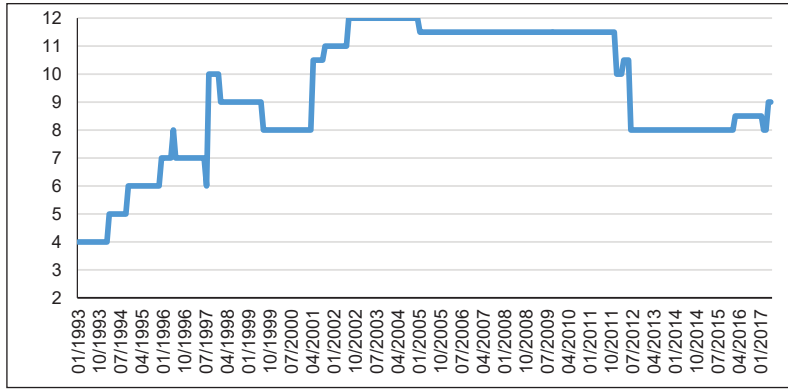

Figure 2.

ICRG Measure of Property Rights in the Czech Republic

Note: The scale is from 0 to 12, with a higher number signifying higher levels of property rights. An index comprised of three sub-components: contract viability, profit repatriation and payment delays.

Source: PRS[4] s. a.

In other institutional arenas, the process of EU accession played a much more explicit role in institutional reform, with the example of the Czech Republic's foreign trade institutions being most relevant. In reality, EU accession helped to pry open the foreign trade regime of then-Czecho-Slovakia in the first instance, allowing it to reorient towards Western Europe and its "natural" trading partners as a second-order effect. As noted above, Czechoslovakia had a much slower liberalisation of its foreign trade regime than either Poland or Hungary, keeping its state monopoly and licensing system for longer. With the signing of the Europe Agreement in 1991, however, a process was put in place for liberalising trade with the EU over a ten-year period, comprising elimination of tariffs and quantitative restrictions but with a more gradual phasing-out of restrictions on "sensitive" industries. (Mastropasqua–Rolli 1994) The EU's insistence on full trade liberalisation helped to disrupt the domestic interests which were dead-set against liberalisation, while the fig leaf of gradualism was enough of a concession to enable the reforms to be carried out successfully. Such an approach was crucial for the Czech Republic, which did not have the same

[4] PRS: The PRS Group, Inc.

"big bang" in trade liberalisation as had occurred in Poland (Hartwell 2016) and, as noted, still had heavy state involvement in the steel sector.

Interdependence and Economic Penetration

The reorientation towards European integration and away from the forced exchange of the CMEA group led not only to a boom in trade and concomitant rise in economic growth, but it also occasioned a massive restructuring of the Czech Republic's economic base.[5] The move towards the CMEA bloc in 1949 had created a major disruption in traditional Czech exports, as the Soviet Union required an "extensive retooling of factories, increased consumption of scarce iron and non-ferrous metals, and recruitment of adolescents, housewives, and farmers into the work force". (Metcalf 1993, 1073) With the removal of planned trade, the Czech economy reverted to its transitional strengths in trade and, more dramatically, to its traditional trade patterns with neighbours, above all Germany (Figure 3).

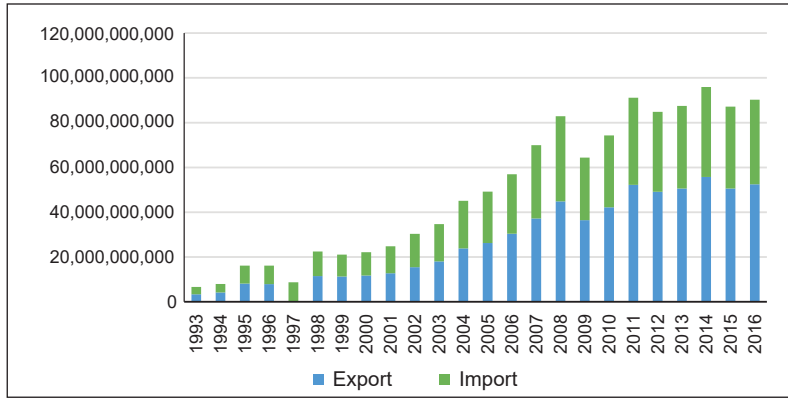

Figure 3.

Value of Czech Trade with Germany (USD), 1993–2016

Note: No data are available for Czech exports to Germany in 1997.

Source: Based on UN Comtrade s. a.

[5] Econometric evidence has also shown that this turn towards openness and especially in the direction of the EU has caused growth in the Czech Republic that was absent during the closed years of late communism. (Awokuse 2007)

Moreover, the pattern of industrial production within the country shifted, as the Czech Republic was now making goods in which it had a comparative advantage for markets that were willing (rather than being told what to do): this has resulted in the motor vehicle industry becoming the reigning champion of Czech exports, ahead of industrial and electrical machinery. More impressively, accession to the EU may have done wonders for the demand for the Czech automotive industry, as, by 2011, manufacturers (predominantly Škoda Auto, with 60% of the Czech car market) were producing double the number of cars they were in the first full year of EU accession (2005). While some have noted that the automotive industry has had little spillover effects in the country, due to the weak position of Czech suppliers *vis à vis* multinational suppliers to the car industry, (Rugraff 2010) other firm-level data has confirmed the importance of foreign companies in the restructuring of the economy of the Czech Republic, including knowledge spillovers. (Kosova 2010)

European integration has also driven a process of convergence in growth and production between the Czech Republic and EU members (in particular with the euro area countries), with cycles (if not necessarily magnitude) becoming more aligned (Figure 4). Indeed, an analysis from the Czech National Bank (2015) notes that only Germany displays a higher correlation with the broader euro area than the Czech Republic, while the country also has some correlation with euro area trends but (as Figure 3 shows) has far outpaced the performance in the EU. This cyclical convergence has been driven mainly by design, as the accession of the country to the EU in 2004 created a natural synchronisation of business cycles, while the Czech flirtation with the euro area and original plans to enter the euro in 2007 (then 2010, then 2012 and now to be determined) meant the country pursued macroeconomic policies designed to meet the Maastricht criteria (although not budget deficits). The intense correlation of activity with Germany has also driven this cyclical convergence.

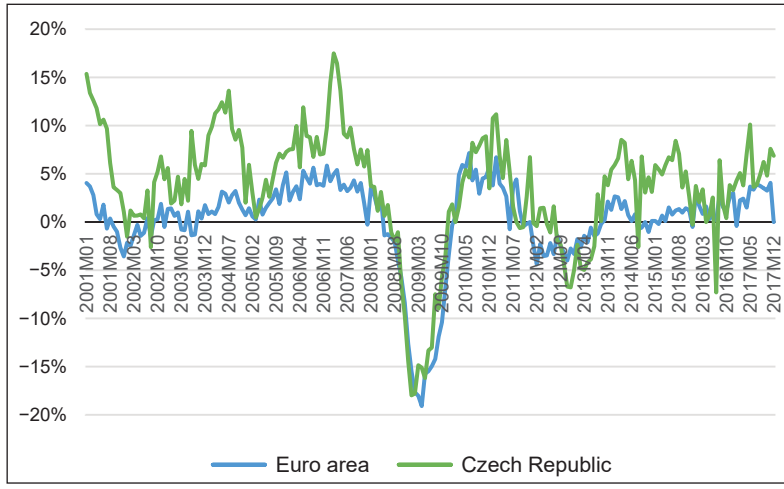

Figure 4.

Convergence between the Czech Republic and the euro area in Industrial Production Trends

Note: The figure shows the industrial production change year on year.

Source: Author's calculations based on Eurostat 2019

Indeed, the most dramatic indicator of interdependence between the Czech Republic and the EU was the massive influx of foreign direct investment which accompanied transition, peaking around the time of EU accession, and, to a large extent, never going away (Figure 5). The Foreign Direct Investments (FDI) which arrived in the transition period played a major role in restructuring the economies of the CEE region and in particular the Czech Republic, as foreign investors did not invest in favoured industries from the communist era but in industries which had perceived medium-term benefits. (Hoekman–Djankov 1997) This selection of new industries for investment eventually also drove the reorientation of trade flows within the Czech Republic, with new products coming on-line, new links with international supply chains forged, and beneficial effects from competition pushing Czech producers to improve their own processes. (Djankov–Hoekman 2000; Kosová 2010) In addition, these results hold not only in traditional goods markets, but there is substantial evidence that investment in services and the concomitant liberalisation in services markets in the Czech Republic also drove productivity gains. (Arnold et al. 2011)

As can be expected, given the advanced reforms of the Czech Republic and its proximity to Germany, the Czech Republic was a natural candidate for an influx of investment from its neighbour. By 1999 (according to United Nations Conference of Trade and Development data), Germany was already responsible for 29.6% of all FDI inflows into the country (the Czech Republic made up 19.55% of all German FDI to the CEE region from 1993 to 2001). Moreover, the linkages between German firms and their investment in the Czech Republic have extended throughout the country and are not just concentrated in major population centres. (Schäffler et al. 2017) While such an eventuality was likely to occur even if the Czech Republic had remained outside the EU, the volumes would most likely have been much smaller; indeed, the performance of German FDI since EU accession shows just how important joining the EU has been to Czech investment flows, as Germany has slipped to third in the rankings of top investors in the Czech Republic, behind the Netherlands and Austria. Such an eventuality would have been patently unlikely in the absence of the Czech Republic joining the EU.

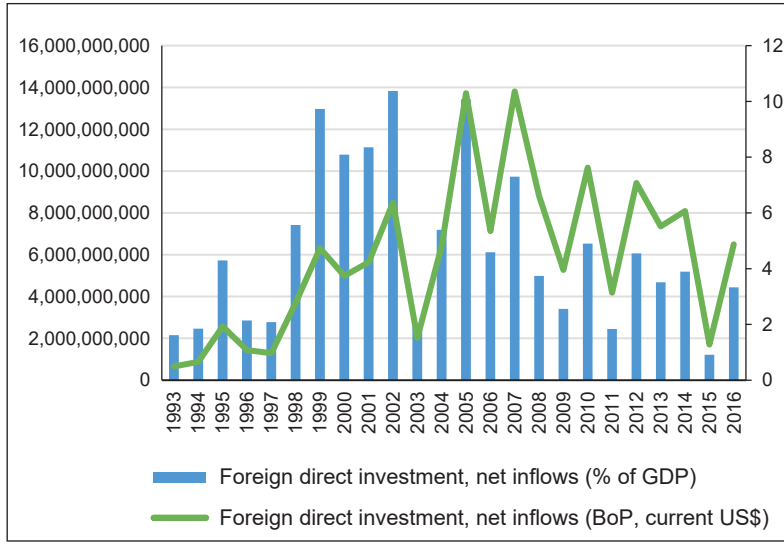

Figure 5.
Net FDI flows into the Czech Republic, 1993–2016
Source: WB s. a.

EU Funds: A Double-Edged Sword

Like many of the EU accession countries of the CEE region, the Czech Republic has benefited mightily in terms of the volumes of EU financial and technical assistance, as well as in its effects on growth. (Becker et al. 2010) Even before accession, the country received a total of EUR 1.062 billion pre-accession financial assistance under the PHARE technical assistance program from 1990 to approximately 2006, an amount far below that of Poland (EUR 3.99 billion) or Romania (EUR 3.67 billion) but ahead of Slovakia (EUR 805 million), according to data provided by Europeaid (2015).[6] After accession, these transfers increased substantially and across a broad range of projects, rising from EUR 2.6 billion from the years 2004 to 2006 to EUR 26.7 billion from 2007 to 2013 and falling slightly to EUR 24.2 billion in the current program (2014 to 2020). The number is projected to fall even more in the coming program, mainly due to the Czech Republic being a victim of its own success, but also due to the lingering effects of Brexit, which will change the calculation of the EU average used in determining the allocation of funds.

While the volume of funds flowing to the Czech Republic has been impressive, a salient question is whether or not the funds have been used to further development (and, by extension, integration with the rest of Europe). Concerns were raised as early as 2002–2003 about the absorptive capacity of the country and the quality of its administration to handle these funds, with the Czech Republic looking better-situated than other accession countries but still underprepared. (Horvat 2005) More recent data, looking at the funding disbursed during 2004–2006 in the new member states, found that countries such as the Czech Republic actually did rather well, outperforming higher-income countries in their absorption. (Tosun 2013) There have been difficulties, however, as, in particular, regional policies were more likely to be small-scale due to the unprepared nature of local administration, meaning that monies were focused on large population centres and highly visible infrastructure projects rather than regional development.[7] (Bachtler–McMaster 2008) While Becker et al. (2010) shows that, on

[6] Data runs through 2006 due to projects starting pre-accession and completing post-accession.

[7] Evidence from Mohl and Hagen (2010) shows that some EU funding could be linked to higher growth in regions of the new EU members, but on the whole, growth was uncorrelated with total amounts spent.

average, structural funds have increased growth in EU accession countries, and especially in the Czech case, they also have had little effect on labour markets or employment.

A somewhat underexplored facet of EU structural funds is how they have impacted the institutional structure of the recipient countries. Of course, it was hoped that the funds would have a beneficial effect, "Europeanising" the institutions of new EU members via conditionality (Haughton 2007) and helping them along with their institutional transformations. (Schimmelfennig–Sedelmeier 2005) The channels in which the funds operated were not always apparent, however, and the aforementioned use of funds for regional development is an instructive case. As Debus et al. (2011) notes, a solution was found at the sub-national level in the Czech Republic for accessing structural funds, with political coalitions forming at the regional level precisely to better obtain funding (put another way, regional political parties often created coalitions based on the need to cooperate with neighbouring regions and thus obtain structural funds). In this manner, not only did EU funding contribute to some measure of development, they also influenced government formation precisely to obtain this funding, an institutional side-effect which was likely unforeseen in the EU's decision to allocate monies.

Beyond this subtle measure of influence on Czech politics, an additional issue regarding the use of structural funds and their institutional impact has been their contribution to corruption, especially in underdeveloped administrative structures such as prevailed in 2004. In particular, a well-developed theme in the foreign aid literature has been the possible deleterious effects of large amounts of aid targeted at sectors where there is cronyism or lingering state involvement; with increasing amounts of public discretion on how and where funds are spent, it is more likely that rents will be extracted and interest groups will pressure for accessing these funds. (Mungiu-Pippidi 2013) In the Czech Republic, there is some evidence that public procurement processes were "bent" in order to advantage favoured clients with EU structural funds, while EU funding faced more incidences of corruption than even nationally-generated procurement. (Fazekas et al. 2014) Moreover, there was a limit to what European integration could do for internal institutions in this realm, as the country's vaunted anti-corruption unit, founded in the run-up to accession, was shuttered immediately upon accession. (Mungiu-Pippidi 2014) In sum, it is easy to see how EU funding may

have actually retarded the fight against corruption in the Czech Republic rather than enabling it, a by-product of structural funding which has a lingering effect in Czech politics today.

The Socioeconomic Effects of Integration

Unlike other countries further east or countries which have faced the prospect of EU accession post-Eurozone crisis, there has been both a political and popular consensus for European integration, manifested in support of formal accession to the EU and for stronger Euro-Atlantic ties in the security and political spheres. As Hanley (2004) noted, despite the presence of two prominent Eurosceptic parties in the referendum on EU accession, the "yes" crowd won the day due to longstanding positive association with the idea of "Europe", with EU accession seen as a logical next step in the country's post-communist transformation.

Ironically, this support of Europe has blossomed even as the country has not availed itself of one of the key tenets of the EU (or at least has not utilised it as much as its neighbour Poland): free movement of people. The Czech Republic, unlike many other countries in the CEE region (or, for that matter, Western Europe) has a fairly stable population, projected to grow slightly (0.1%, according to the OECD) in coming years before falling near the end of the century. A driving force behind the country's population stability has been generally muted migration; according to UNICEF, in 2013 the Czech Republic had lost a mere 2.9% of its population to migration, with the vast majority (62%) of emigrants heading to either Germany or Slovakia. Moreover, out-migration has been almost entirely exactly balanced by inward migration from Ukraine, Slovakia, Russia, Poland, and (somewhat surprisingly) Vietnam, as immigrants in 2013 numbered 314,029 while emigrants totalled 315,148.[8] By 2017, according to Eurostat data, the number of immigrants had increased to approximately 4.3% of the Czech population (approximately 465,000), a number which surpassed by 20,100 the number of out-migrants.[9]

[8] For more data see the UNICEF's "Migration Profile" of the Czech Republic. (UNICEF s. a.)

[9] Data obtained from Eurostat tables "Population change—Demographic balance and crude rates at national level" (demo_gind) and "Foreign-born population by country of birth" (migr_pop3ctb) (Eurostat s. a.)

While some Czechs have gone into the EU neighbourhood to seek their fortune, the Czech experience is wholly different from that of CEE countries such as Poland and Romania, which have seen a much larger brain drain. In fact, the Czechs have seen more "brain circulation", with those going abroad returning home in much larger numbers than other CEE countries. This does not mean that there have not been localised shortages of workers in particular sectors, however, and it is has been noted for some time (Wiskow 2006) that doctors are becoming in short supply in the country. According to the President of the Czech Medical Chamber, in 2015, 20% of doctors granted degrees promptly left to take up positions in foreign countries, with some of the vacancies (but not all) being filled by Slovak, Ukrainian and Russian doctors.[10] Similarly, IT firms have also faced labour shortages due to migration, (Vavrečková–Baštýř 2009) but, as Bernard et al. (2014) details, the Czech Republic has been very successful in attracting skilled professionals to its "islands of innovation". In sum, it remains the medical profession which is under stress, as other facets of brain drain appear to have passed the country by.

Conclusions: An Unavoidable Integration

This chapter has examined the integration processes of the Czech Republic with an eye on its institutional development in the post-communist transition. Despite recent political shifts, the Czechs remain firmly ensconced in Europe geographically and economically, with intense relationships developed with other European countries within the EU. Given these complex interrelationships and benefits accruing to the country (and a generally favourable attitude towards the EU as an economic union), it is unlikely that there will be substantial changes in the Czech Republic's relationship with Brussels in the future. In fact, despite having less favourable initial conditions than other CEE countries, the Republic has thrived and successfully integrated into the European project […] but only up to a point of Prague's choosing.

[10] Based on an interview with Czech Medical Chamber President Milan Kubek. (Radio Praha 2016)

In reality, the gradual shift towards a more Eurosceptic orientation in the Czech Republic regarding the political aspirations of the euro area has occurred alongside changes in Central Europe more generally (i.e. in Hungary and then Poland), but must also be seen in light of a longstanding tradition in Czech politics. It has been a tenet of post-communist policymaking that the Czech polity has split in favour of the EU's economic benefits while against EU political aspirations and talk of closer political union. (Havlik 2011) In part, this has been due to the tight economic intertwining of the Czech Republic with Germany, meaning that economic issues are seen as bound to the EU, coupled with the reality that Czech security policy is not guaranteed by the EU but instead by NATO and the transatlantic alliance. Such an approach has led to seemingly contradictory policies: for example, the current Czech stance towards adopting the euro appears to go against the economic interests of the country with regard to its main trading partners. Indeed, while former countrymate Slovakia adopted the euro as soon as it was able (2009), the Czech Republic and its citizens have shifted from the optimism of the early 2000s to be stalwartly against the common currency. However, seen through the political/economic prism, there is a widespread consensus in the Czech Republic (one that is close to the truth) that the euro is not an economic project but is a political one, and thus the country should maintain a degree of policy independence rather than subordinate decision-making to Brussels and Frankfurt. (Pechova 2012)

The recent political successes of President Miloš Zeman and Prime Minister Andrej Babiš can be seen in this larger context of Czech approaches to European integration but, like their nationalist/populist counterparts in Hungary and Poland, there is a possibility that such reflexive anti-EU stances can go too far. As noted earlier, the Czech Republic has benefited extensively from being an EU member, and while European integration is not synonymous with the EU, there is a large amount of overlap. Even though the European experiment has somewhat gone off the rails since the global financial crisis (and recent policy proposals have attempted to make "the euro area" synonymous with "the EU"), the Czech Republic must keep its eyes focused on making the union a better economic vehicle. This approach, remaining aloof from political diktats but playing a constructive role in economic policymaking, will have continued benefits for the country in the future.

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Vákát oldal

Chapter 4.

Economic Integration and Interdependence in Hungary

Challenges and Experiences Since the Fall of the Iron Curtain

Attila Kovács

Introduction

After the fall of the iron curtain, Hungary started its economic transformation with an uncompetitive economic structure. The previously state-owned enterprises had monopoly positions in the markets of the socialist bloc, facing no or minimal competition. Given the high economic exposure of Hungary to the Soviet markets, the rapid collapse of these markets left the country unprepared. Additionally, the high level of indebtedness of the country also put immense pressure on the restructuring of the economy. Hungary's economic transformation and integration into the countries of the then European Economic Community and the European Union started with rapid privatisation, export-oriented policies and austerity measures. Nevertheless, this was accompanied by a high level of unemployment and social tensions.

The objective of this paper is to give an overview on the economic and social development of Hungary since 1990. In this context, special emphasis will be devoted to the process of EU integration as well as the country's trade and Foreign Direct Investment (FDI) relations. The core of the analysis is the interrelatedness and integratedness of the Hungarian economy into the European Union.

The paper is structured as follows. First, I give a review of the conditions at the beginning of the integration process and an insight into the political

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and economic transformation process of Hungary in the 1980s and 1990s. Then, the macroeconomic performance and economic interdependence of the country will be analysed. This section deals with Hungary's situation from an economic and social development point of view, with special emphasis on FDI, trade, globalisation indices and economic complexity. Finally, the paper has a conclusion and outlook.

The Conditions at the Beginning of the Integration Process

Although Hungary's economic transformation has started back in 1968, the most important steps took place from the beginning of the 1980s. In this section I give a brief overview based on Zídek's article. (Zídek 2014)

In the 1980s, foreign direct investment was already allowed in Hungary and some joint-ventures with western companies appeared. Hungary became a member of the International Monetary Fund (IMF) already in 1982. The country agreed on a standby program as early as 1988. Hungary passed a bankruptcy law in 1986. A two-tier banking system was introduced in 1987—the previous monobank split into the central bank and 3 commercial banks. The economy started to open that year, too; Hungarian companies were allowed to trade internationally on their own accounts. A new commercial code was approved in 1988. The government started to transform state companies into joint-stock companies in 1989. Hungary was the first country of Central Europe to have incorporated value added tax into the tax system, which occurred in 1988. Price liberalisation took place already in 1989.

Ownership structure changed as well. Bethkenhagen (1989) wrote that the private sector had created 3% of national product in 1970. In 1989 it was already creating more than one quarter (Holman 2000) and two thirds of Hungarians had an income from private activity in addition to their main jobs in a state company or a cooperative. The privatisation process showed differences among the central European countries at the beginning of the transformation process. As far as ownership is concerned, the biggest difference was in the role of managers of state companies. As a consequence, the managers were allowed to gain control over thousands of companies in Hungary already at the end of the 1980s. This process is sometimes called spontaneous privatisation. The following two tables (Table 1 and 2) show the increasing role of the private sector (private companies) in the Hungarian economy after the fall of communism.

Table 1.
Private sector share in GDP (%)

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Hungary	25	30	40	50	55	60	70	75	80	80	80

Source: Zídek 2014

We can see that the share of the private sector in the total GDP increased from 25% in 1990 to 80% by 2000. Also, we can see that state ownership radically decreased between 1992 and 1996, while individual private, domestic corporate and especially, foreign ownership increased rapidly and significantly.

Table 2.
Ownership of manufacturing firms, % of registered capital

Types of ownership	1992	1993	1994	1995	1996
State	55.2	39.2	29.3	19.9	14.4
Municipal	8.8	1.6	1.6	1.0	0.9
Individual private	N/A	8.8	9.4	10.1	9.5
Domestic corporate	0.1	15.0	17.9	18.2	19.4
Employee	20.5	1.0	1.5	1.4	1.2
Foreign	3.6	30.9	37.1	46.7	51.1
Cooperative	N/A	2.6	1.9	1.4	1.2
Other	N/A	0.9	1.3	1.3	2.3

Source: Zídek 2014

The first post-communist government entered into office in 1990. One of its achievements was that Soviet troops left Hungary in the middle of 1991. In the same year, the association agreement with the European Community was signed as well. A very tough new bankruptcy code was in effect from the beginning of 1992. If a company was not capable of paying its debts within 90 days, it had to call to start bankruptcy proceeding itself. (Zídek 2014) Following the demise of communism, the process of normalisation of Hungary's engagement in external commercial relations has progressed rapidly. In 1989, the EU granted Hungary the General System of Preferences (GSP), which significantly improved conditions in access to EU markets. The interim trade agreement of the Europe Agreements (EA), which was signed in December 1991, came into effect in March 1992. The preferential trade agreement with European Free Trade Association (EFTA)

in 1992, modelled after the EA, was followed by Central European Free Agreement (CEFTA) which entered into force in 1993. As a result of the implementation of these agreements combined with the new European-wide system of cumulation of rules of origin, almost 60% of Hungary's trade are subject to preferential arrangements. In 1998, all its exports of manufactures have unfettered duty-free access to EU markets. With the entry into force of the Pan-European Cumulation Agreement on July 1, 1997, Hungary has become part of a multilateral free trade area encompassing the EU, EFTA and nine other Central and East European Countries – Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. (Kaminski 1999)

Economic transformation in Hungary had high economic and social costs (Table 3). Hungary suffered similar (or deeper) decline as other countries in Central Europe. The unemployment rate was relatively high. Inflation development did not embrace the typical jump after the price liberalisation (that took place in other countries) but there was a continuously higher inflation rate. On the positive side, a relatively high level of foreign capital was flowing into the country. It had again its roots in the previous liberalisation because foreign investors were familiar with the situation in Hungary. (Zídek 2014)

Table 3.

Basic economic indicators at the beginning of the 1990s

Indicator	Hungary
Inhabitants in millions	10.36
Employment in industry % of total	29.7
Investment in %	29.7
GDP in billions $ PPP	59.6
GDP/person $ PPP	5,750
EX per person in $	922
IM per person in $	832
Gross external debt per person	2,077

Source: Chvojka–Zeman 2000

Hungary was deeply affected by the disintegration of the Council for Mutual Economic Assistance (CMEA). Hungarian exports declined by roughly one quarter, which was much less than in some of the other countries. The country generally followed the path to liberalisation of international trade as other countries of the Eastern bloc. In 1990, tariffs declined and quotas on

consumption goods were abolished. Hungarian trade quickly re-orientated towards western markets. EU15 had already had a 34% share of Hungarian exports as early as in 1989. This number rapidly increased to 50% in 1991 and 70% in 1997. The role of goods in the exports into the EU had grown as well—from 55% in 1989 to 85% 1997. (Stojanov 2004 In: ZÍDEK 2014) Germany became Hungary's main trading partner, just as it became for the other Central European countries. (Zídek 2014)

Developments in Hungarian foreign trade seem to suggest that Hungary has achieved impressive results in both production and trade reorientation. A cursory examination of exports to the EU points to two different phases—1989–1992 and 1993–present. The first phase witnessed an initial expansion in exports followed by their contraction in 1993. The expansion in exports to the EU, triggered by the collapse of former CMEA markets and the liberalisation of imports and exchange rate regime, was mainly driven by a redirection of manufactures exports to Western, mostly EU, markets. The value of exports increased by 84% between 1989 and 1992. This expansion lost steam in 1993 at which time the value of EU oriented exports fell by 12%. But exports subsequently regained their dynamism, registering an exceptionally strong performance over 1994–1997 with the value of exports increasing by 132%. (Kaminski 1999)

It seems that the rapid pace of turn around has a lot to do with the emergence of "second generation" firms-mostly foreign owned. Foreign-owned firms tend to be more export oriented and more profitable than domestic-owned firms are. Thanks to a friendly environment to FDI since the outset of transition, Hungary has been the most successful transition economy in terms of attracting foreign investors. Over 1990–1997, Hungary absorbed around one-half of all foreign capital invested in Central Europe. The inflows did not concentrate in the more recent period (as they did in Poland) but were already large in terms of GDP over 1990–1994, which allowed a considerable lead-time to have an impact on the economy. Thus the catalyst for a reorientation of Hungary's commercial relations was the demise of whatever was left of central planning associated with the rapidly declining Soviet capability to sustain "soft" settlements in intra-CMEA trade which eventually led to its dissolution. In the second half of the 1980s, the combination of the falling oil price in intra-CMEA trade and cuts in Soviet deliveries encouraged former CMEA-members to restrain exports to the former Soviet Union (FSU) and increase exports to hard-currency markets. This heralded a return to trade patterns determined by economic

rather than political considerations. The share of former CMEA fell from 60% in 1986 to 38% in 1990 and to 20% in 1997. Despite this long term of declining trade with the former CMEA, the challenge of readjustment of trade patterns in the early 1990s was formidable. We should consider that the previous two decades had witnessed declining competitiveness of Hungarian exports in Western markets and that many Hungarian firms operated in "soft" CMEA markets devoid of competition and dominated by products of shoddy quality. Furthermore, although the price of oil supplied by the former Soviet Union—based on a moving five-year average—was close to the world price, Hungarian products exported would purchase more oil there than elsewhere. Thus, in addition, the shift to convertible currencies in CMEA trade, combined with a rapidly falling import demand in the FSU, amounted to a significant deterioration in Hungary's terms of trade mainly with the FSU.

Hungary has successfully coped with these challenges. The volume of total exports fell by 5% in 1991; was flat in 1992; took a dive of 13% in 1993; and increased by 17% in 1994. By around 1994–1995, the volume of total exports exceeded the 1989 level, and the share of developed countries in Hungary's exports has moved to around 70% in line with what one might expect given Hungary's proximity to EU markets. The changes on the import side were even more pronounced. As a result, the process of geographic reorientation to market-driven patterns of foreign trade was quickly completed. (Kaminski 1999)

Foreign Direct Investment played a role in the Hungarian economy since the early years of the 1970s (Table 4). Although this role was very limited, it is still noticeable that foreign capital could appear in the economy of a communist country. In 1972, Hungary made a historically interesting and unique decision to authorise the establishment of joint ventures with western companies. Pursuant to this decision Siemens, a German company, was the first to set up a joint venture in Hungary in 1974 under the name of Sicontact. Many years ago, during the 1880s Siemens was already among the major investors. One year before the change of regime in 1988, Hungary authorised the establishment of 100% foreign-owned companies, which was a radical turning point and signalled Hungary's desire and ambition to become reintegrated into the world economy. At the end of the 1980s, direct investments in Hungary were dominated by German (and Austrian) capital. By the end of 1989, Germany invested 37 million euros of FDI in Hungary. (Kőrösi 2009)

Table 4.
FDI inflows in Hungary in USD million (1972–2000)

Year	In cash	Of which privatisation income	as %	Investment in kind	Total
1972–1989	387	–	N/A	783	1,170
1990	311	20	6.4	589	900
1991	1,459	435	29.8	155	1,614
1992	1,471	492	33.4	170	1,641
1993	2,339	1,163	49.7	142	2,481
1994	1,147	103	9.0	173	1,320
1995	4,453	3,370	75.7	185	4,638
1996	1,983	618	31.2	57	2,040
1997	2,085	1,827	87.6	22	2,107
1998	1,935	485	25.1	11	1,946
1999	1,651	295	17.9	6	1,657
2000	1,600	–	–	0*	1,600
1990–2000	20,434	8,808	43.1	1,510	21,876

* In the fiscal year 2000, this figure was equal to USD 280.00—which is 0 while rounded to millions.

Source: Csáki 2002

Foreign direct investments played a very important role in the economic transformation of Hungary. In the 1990s, foreign companies gave almost half of the employment, more than 80% of the total investments and almost 90% of the total export (Table 5).

Table 5.
Share of foreign companies in the industrial sector at the end of the 1990s

Country	Employment	Investment	Sales	Exports
Hungary	47%	82%	73%	89%

Source: Berend 2009

Csáki (2002) lists a number of locational advantages of Hungary to attract FDI. Hungary's early advantages over its regional competitors in terms of FDI attractiveness was due to several different factors, such as:

- early establishment of the legal and regulatory environment adequate to a modern market economy;

- early liberalisation of both commodity, service and capital inflows—even without a fully convertible currency;
- important tax allowances were provided to foreign investors since 1988;
- Hungary has a fortunate geographical position in Central Europe—on the one hand, the country is historically in a transit position between North and South as well as East and West, on the other hand, Hungary is geographically close to some very important potential investors, such as Germany, Austria and Italy;
- at the time of the change of regime Hungary had, at least in regional comparisons, relatively high standards of entrepreneurial spirit – which was, certainly due to the relative corporate independence introduced in the framework of the so-called "new economic mechanism" in 1968;
- in the framework of the legal and regulatory reforms in 1987–1988, relatively early reforms of financial intermediation also took place: a two-tier banking system was established as early as in 1987, foreign banks and insurance companies were authorised to set up their affiliate companies since 1988.

Csáki distinguishes three phases of FDI inflows in Hungary, which are as follows:

- an early phase occurred in 1988–1992, based upon Hungary's above described early advantages. Till the end of 1992, about USD 5 billion FDI were attracted which was by far the largest amount of foreign capital attracted by one single Central and/or Eastern European country. Early investors were fairly different from the ones in the successive phases. Those who had well known the Hungarian market (former foreign trade partners or/and traditional investors from and of the region) set up joint ventures in order to penetrate the Hungarian market;
- in the second phase of FDI inflows, between 1993–1998, Hungary's inward FDI attraction was characterised by the dominance of privatisation. The Hungarian privatisation was always based upon market methods: in Hungary there was no voucher privatisation or any other kind of free of charge asset provisions. In Hungary, even preferential privatisation methods, such as compensation vouchers, existence credit facility, start-up credit facility, privatisation leasing, etc., all

could have been used exclusively on the market (as a bid) and had to compete with bids in cash. With very few exceptions (mostly in case of medium-sized state-owned companies), when foreigners were excluded, Hungarians had to compete with foreigners, and the latter always had a much stronger capital position. That is why foreigners dominated the Hungarian privatisation process: not less than 71% of total FDI inflows was carried out by foreign investors;

- since 1999 Hungarian FDI entered the third phase that can be described as a period between privatisation and EU accession. As it is obvious, privatisation has ceased to be the main source of Hungarian FDI inflows. Therefore, on the one hand, then yearly FDI inflows decreased significantly, on the other hand, nowadays, inward FDI is fuelled mostly by the multiplier effects of earlier investment and reinvested profits. (Csáki et al. 1996)

Kaminski (1999) adds that FDI has played a pivotal role in reintegrating the Hungarian economy into international markets. A huge portion of investment has come from large multinational corporations (MNCs) with global networks of production and marketing. As a result, a significant share of Hungary's domestic business activity has been incorporated into these networks. Moreover, most FDI has come to Hungary not as a way of jumping trade barriers but to take advantage of the overall economic environment including location, the cost of factors of production and transaction costs. The data on profitability and export-orientation of foreign owned firms appears to confirm this observation. As a result, the proportion of FDI in inefficient industries supported by unearned "rents", which usually roils the social and political atmosphere, seems to be negligible.

In Hungary, political change managed to evolve without mass demonstrations and strikes in a politically calm and peaceful environment. The so-called "round-table" negotiations defined the framework and the sequence of the political shift to democracy with the consent of the communists. (Benczes 2009) The reform tradition and the relative successes did not prevent Hungary from implementing a series of painful reforms. Transformation recession totalled at 18% of the GDP by 1993, and Hungary experienced the most dramatic fall in employment in turn in the region. From its 1989 level, employment declined first to 87% by 1991 and then further down to 72 by 1994. The numbers for the same period were 90 and 85.5 in Poland and 93.5 and 90.5 in the Czech Republic. Unemployment reached double-digit numbers

in the first half of the nineties; it peaked at 12 in Hungary. (Basu et al. 2000) In fact, the gradualist character of the economic transformation was not the result of a conscious decision of the first freely elected government, but a historically determined outcome of a two-decade long reform process, which culminated in the political change of 1989. Applying the term "gradualist" with regard to Hungary is therefore misleading. Originally, the theorists of gradual reforms favoured a sequenced and embedded reform process and argued against the total suspension of past capacities, since it would have triggered an unnecessary fall in supply, ending up in impoverishing and frustrating citizens. The early years of the Hungarian transformation, however, according to Csaba (1995), were burdened with ambiguity in policy decisions and a lack of coherence.

Macroeconomic Trajectory of Hungary after the Fall of Communism

This section gives an overview on the most important macroeconomic and political trends in Hungary. Depending on data availability, some of them are from the 1990s, while others are from the 2000s, covering the period of Hungary's EU membership.

Hungary started the decade of the 1990s with a significantly high level of central government debt. This was the result of the increased level of social benefits to be transferred to unemployed people due to the elevated level of unemployment. Also, lots of previously state-owned companies went bankrupt and were not able to pay corporate taxes, therefore decreasing the revenue side of the state budget. The gap in the budget was filled by taking more and more credits by the state of Hungary, increasing the indebtedness of the government. We can also see in Figure 1 that following the stabilisation package in the mid-1990s (Bokros-package), government debt sharply and significantly decreased until the early years of the 2000s (first government of Viktor Orbán). Nevertheless, the left-wing government, which entered into power in 2002 increased social benefits and salaries of public servants, which largely contributed to the enhanced level of government debt. This tendency was aggravated by the 2008–2009 crisis, which caught Hungary off guard and the country needed to turn to the IMF to get loans. Since then, government debt is stagnating at a relatively high level.

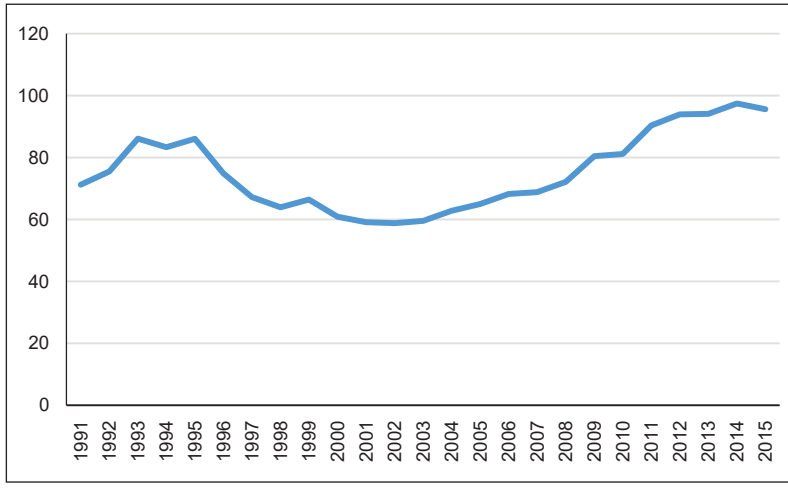

Figure 1.
Central government debt, total in Hungary (% of GDP)
Source: WB[1] 2018a

The current account balance in Hungary showed a negative picture in the 1990s, when the traditional export markets of the country collapsed (post-Soviet countries and countries of the CMEA). Therefore, many domestic companies were unable to compete with foreign competitors (due to the obsolete technological background and the outdated product range) and the import to the country was high. This lasted until Hungary's EU accession, after which we can see a gradually improving current account balance for the country, positive since 2009 (Figure 2).

[1] WB: Word Bank.

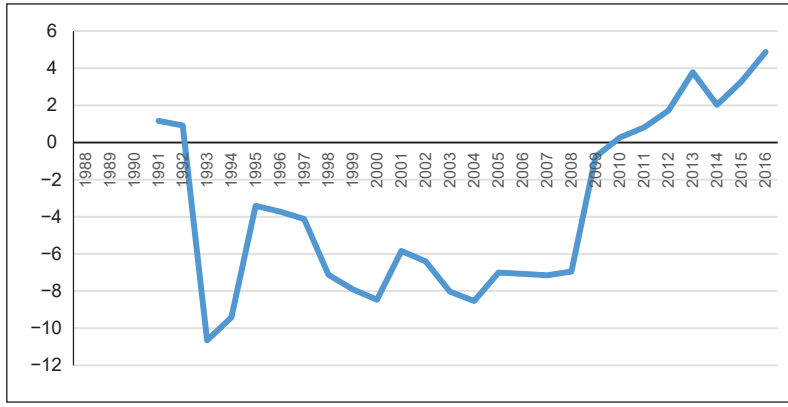

Figure 2.
Current account balance in Hungary (% of GDP)

Source: WB 2018a

Net trade in goods and services is derived by offsetting imports of goods and services against exports of goods and services. Exports and imports of goods and services comprise all transactions involving a change of ownership of goods and services between residents of one country and the rest of the world. The chart of net trade in goods and services also confirm the previously mentioned tendencies in Hungary (Figure 3). A slightly positive trade balance in the last years of the 1980s sharply turned into negative in the very first years of the 1990s, after the mass bankruptcy of state-owned Hungarian companies and the collapse of the markets of the Soviet bloc. This was followed by a volatile period of approximately 10 years. Since 2004, Hungary's EU accession, the volume of trade increased significantly, mostly due to the access to EU markets. This clearly shows that the Hungarian economy is deeply linked and integrated into the economic body of the European Union.

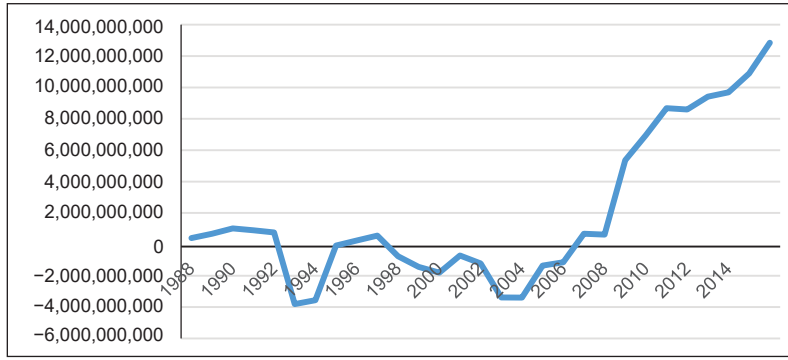

Figure 3.
Net trade in goods and services in Hungary (BoP, current USD)
Source: WB 2018a

The Human Development Index (HDI) of the United Nations has shown a steady increase in Hungary in the last 25 years (Figure 4). Interestingly, the cutbacks in social benefits, the increased level of unemployment after the fall of the communist system are not reflected in the trend. It is also worth mentioning that the level of the minimal wage and other social benefits has increased recently in Hungary, justifying the betterment of the Human Development Index. Also, the EU funds played an important role in this, as a significant percentage of them addressed human development type of projects, especially in education and healthcare.

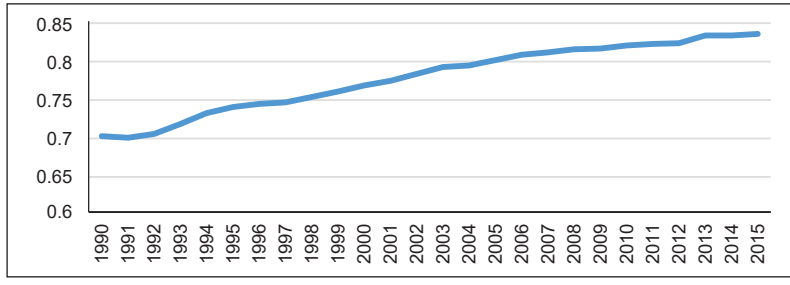

Figure 4.
Human Development Index in Hungary
Source: UNDP[2] 2015

[2] UNDP: United Nations Development Programme.

Looking at the annual GDP growth rates in Hungary in the last 25 years, we can easily identify some important milestones in the economic policy and the international economic environment of the country (Figure 5). First, there was a fallback in the GDP (negative growth) in the early years of the 1990s. Then, between 1994–1996, the decline in the GDP growth triggered the launch of the austerity measures in Hungary (Bokros-package). This induced economic growth in the coming years. Nevertheless, since 2004—the year of EU accession—GDP growth started to mitigate (parallel with the increase of budget deficit), which turned into negative after the sharp decline in the 2008 financial crisis. Since then, GDP growth values show strong volatility but are positive in the last 5 years.

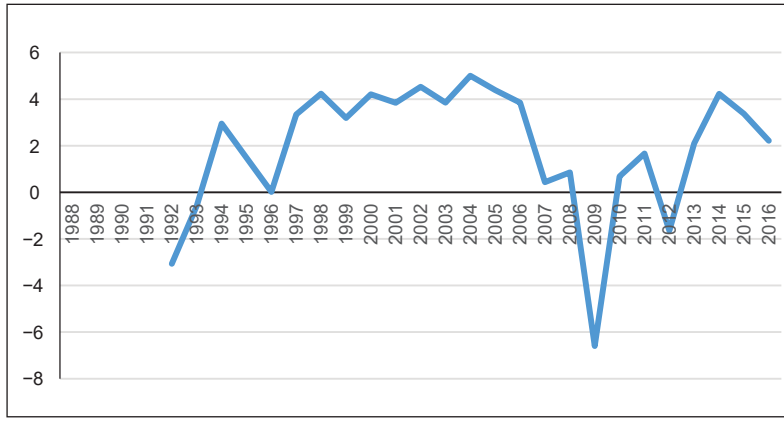

Figure 5.
GDP growth in Hungary (annual %)

Source: WB 2018a

Total and per capita GDP in Hungary shows a similar pattern in the last 25 years (Figure 6 and 7). Relatively modest growth between 1990 and 2000 was followed by a sharp and more significant boost until the 2008 crisis. Since then, total and per capita GDP in Hungary has fallen back and been stabilised at a lower level. The country still has not managed to reach the pre-crisis level of total and per capita GDP.

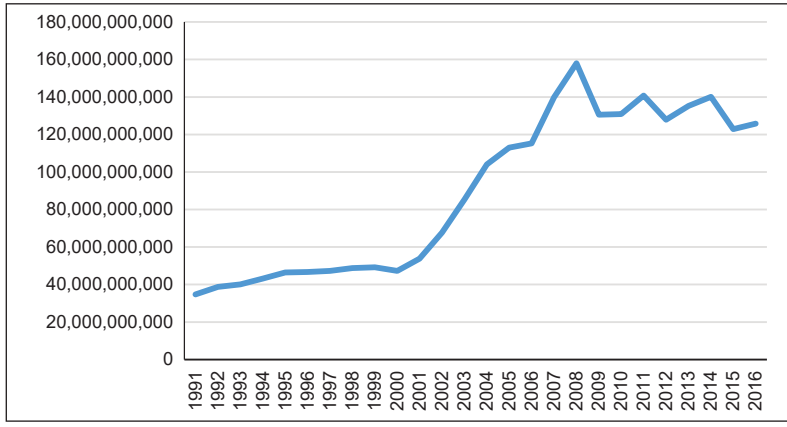

Figure 6.
GDP in Hungary (current USD)

Source: WB 2018a

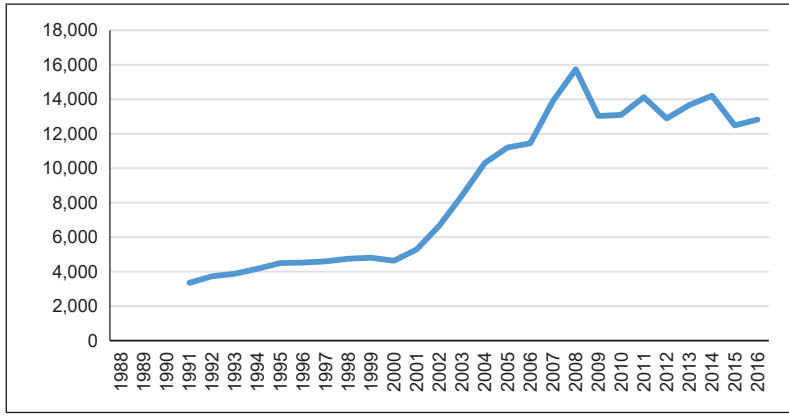

Figure 7.
GDP per capita in Hungary (current USD)

Source: WB 2018a

The Freedom House evaluates countries according to the freedom of political rights as well as civil liberties. The scaling is from 1 to 7, where 1 expresses the best status of a country, i.e. complete freedom for exercising political rights and civil liberties. Since the late 1980s, as the result of the democratic

transformation, Hungary's ranking quickly improved, reaching the best status by 1994. This best category was sustained until 2014, when the classification quickly deteriorated, reaching the category of 3 by 2017. Regarding civil liberties, a similar pattern could be observed, with the distinct difference that the best classification has been reached in 2004 and was sustained until 2012 (Figure 8 and 9).

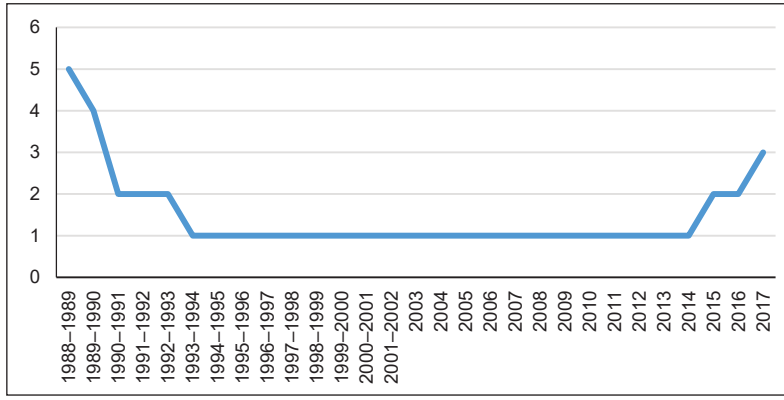

Figure 8.
Political rights in Hungary
Source: Freedom House 2017

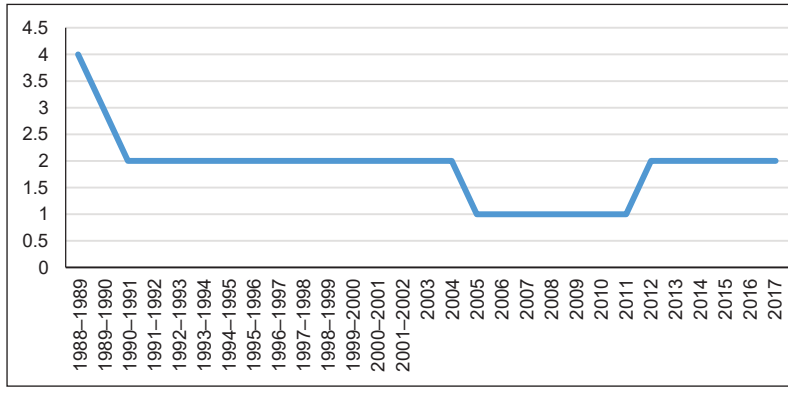

Figure 9.
Civil liberties in Hungary
Source: Freedom House 2017

The Doing Business ranking of the World Bank shows practically a stagnation for Hungary between 2005 and 2018 (Figure 10). Although literally, there is a slight increase—from the position of 52 to the position of 48—nevertheless, most of the rankings in the covered period varies in the range of the 40s. We can see a steady decrease in the ranking after 2008 until 2015 and a sharp increase from 2015 to 2016. This latter one could be attributed to the simplification of business environment (flat rate taxes, for example) implemented by the Hungarian Government.

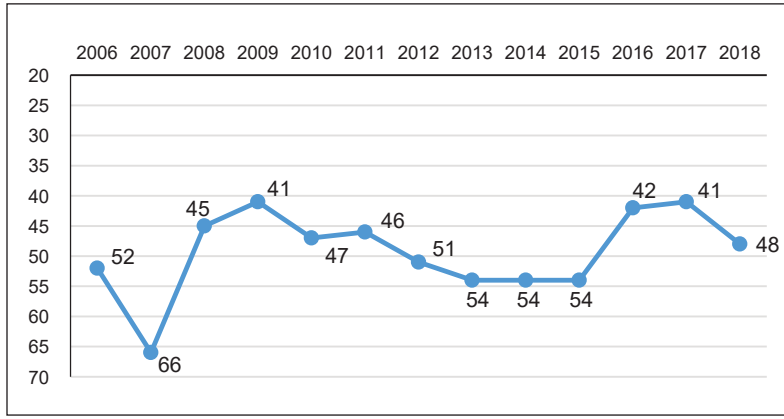

Figure 10.
Doing business ranking, Hungary

Source: WB 2018b

The Global Competitiveness Index (GCI) depicts a darker picture about Hungary's competitiveness in the last 10 years (Figure 11). Hungary has fallen back with more than 20 positions from 47 to 69. The World Economic Forum lists inadequately educated workforce, corruption, tax rates and tax regulations as the biggest problems and obstacles to increase the competitiveness of the country (Figure 12). Regarding the methodology of the scaling, it should be noted that from the list of factors, respondents to the World Economic Forum's Executive Opinion Survey were asked to select the five most problematic factors for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

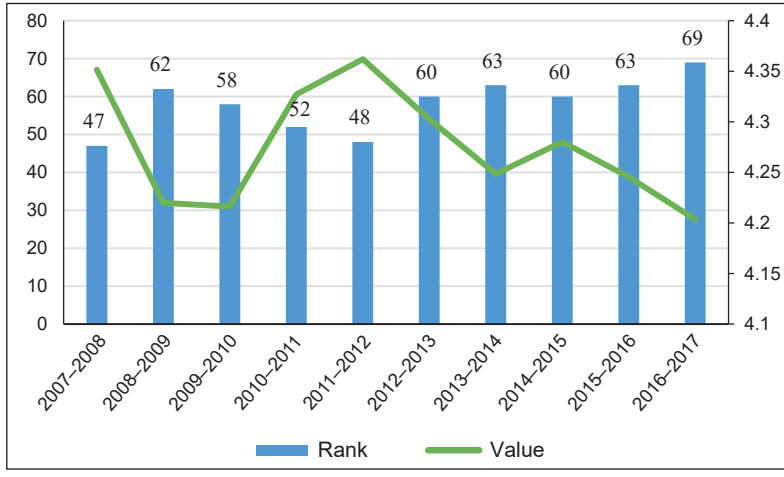

Figure 11.

Global Competitiveness Index, Hungary

Source: Schwab–Porter 2008; Sala-i-Martin 2011; Schwab–Sala-i-Martin 2017

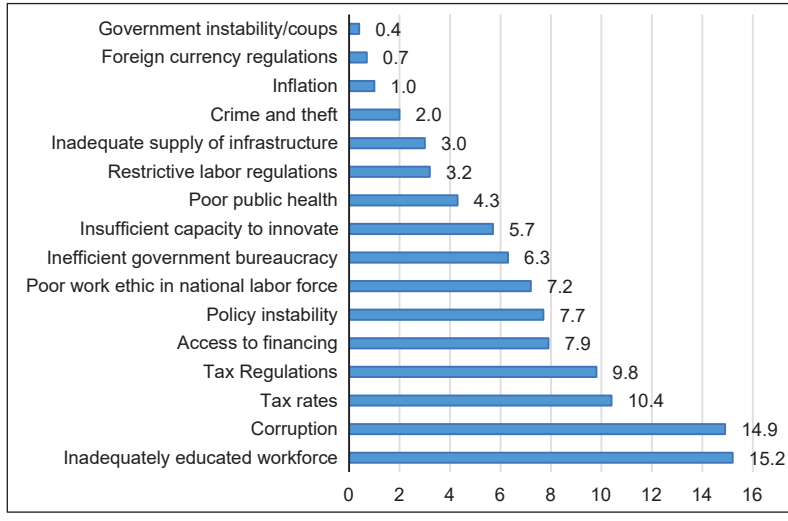

Figure 12.

Most problematic factors for doing business in Hungary

Source: Schwab–Sala-i-Martin 2017

The World Bank Worldwide Governance Indicators (WGI) give a picture on the political and regulatory setup and status of a country. According to two indicators of WGI, Hungary's position is deteriorating. Both political stability and the control of corruption shows a worsening picture in the last 20 years (Figure 13 and 14). World Governance Indicators measure a country's performance on a range of –2.5 (weak) to 2.5 (strong) governance performance.

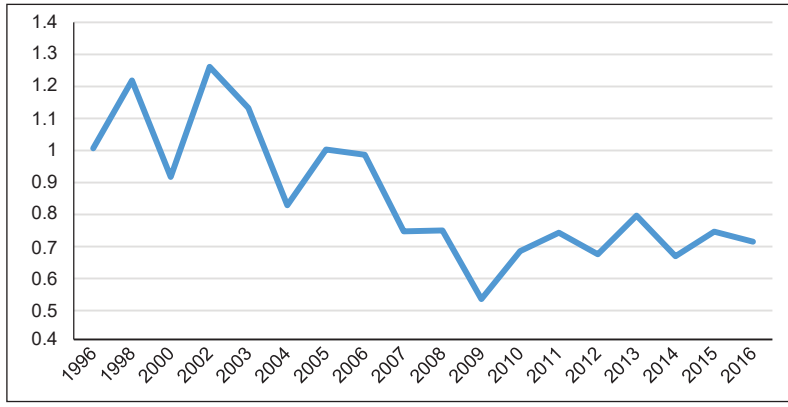

Figure 13.
Political stability/No violence in Hungary

Source: WB 2016

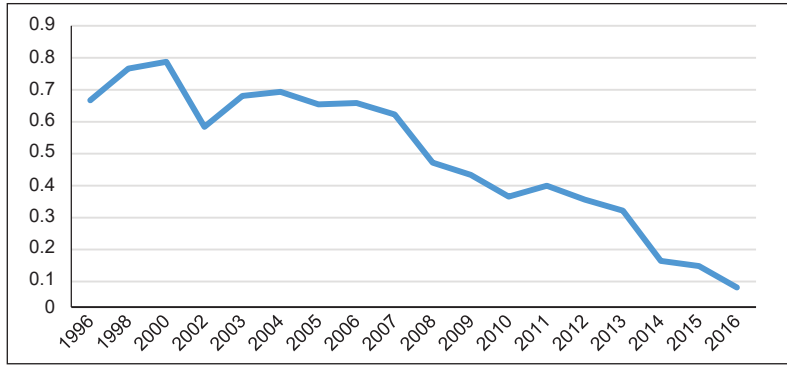

Figure 14.
Control of corruption in Hungary

Source: WB 2016

Hungary's EU Membership and the Use of EU Funds

Still today, there is a vivid discussion about the pros and cons of Hungary's EU membership. This section aims to give some hints to this debate by providing some analysis from various aspects.

Hungary's net financial position to the EU can be calculated since the year 2000, when Hungary started to receive EU funds in the framework of the pre-accession funds. Since then, Hungary has a net financial position to the European Union in terms of financial transfers, which means that the country received more financial transfers from the EU budget than it paid to it (Figure 15).

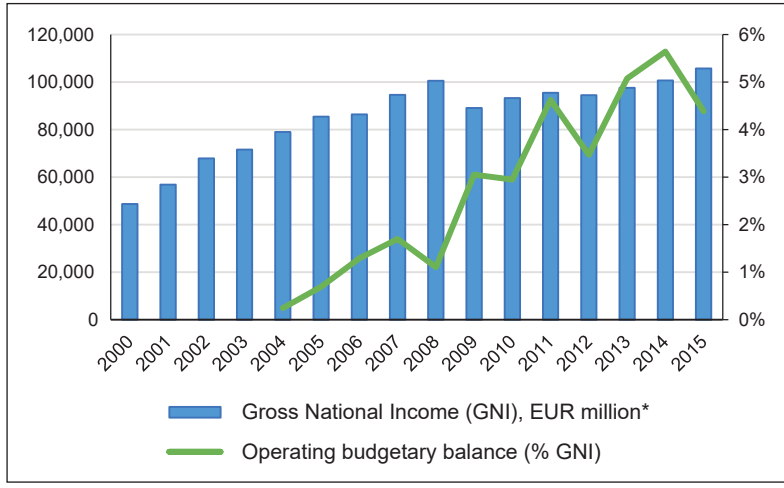

Figure 15.
Hungary's net financial position to the EU

Source: EC[3] 2015

Since the country's EU accession, Hungary has been a net beneficiary country in the European Union. Since the year 2000, Hungary received a total amount of almost 44.0 billion Euros of EU funds. In this period, the net financial balance for Hungary has been 33.0 billion Euros. During its EU membership, Hungary received an annual average of 2.8% of its Gross

[3] EC: European Commission.

National Income (GNI) as EU resources. The total amount of EU contribution of agricultural and rural development funds between 2000 and 2020 has been almost 8.5 billion Euros, triggering a total amount of spending and investment of more than 10.0 billion Euros.

Table 6 gives an overview on the main economic trends in Hungary since the country's EU accession. Per capita GDP shows the same tendency as total GDP: a sharp drop in 2008, and a recovery period until 2015 followed a gradual increase. Today, per capita GDP is almost 30% higher than at the time of the country's EU accession. Regarding innovation, Hungary's innovation potential is still lagging behind the European average. In 2016, the country spent 1.6% of its GDP on research and development. It is a gradual and steady increase compared to 2004, when this value was only 0.86%. In 2016, Hungary took the 14th position in the EU regarding R&D spending on GDP. (Eurostat 2017a) Regarding the Global Innovation Index, Hungary took the 39th position globally in 2017, ranked 24th out of the 28 EU Member States. Ten years before, in 2007, Hungary was ranked 36th globally, but 17th in the European Union. This means a decline in intra-EU comparison in the last ten years (GII 2017). According to the World Intellectual Property Organization (WIPO), Hungary experienced a negative tendency between 2004 and 2015 regarding "Patents in force" – 28th global position in 2004, 41st in 2015 – and also in "Resident patent applications": 33rd global position in 2004 and 40th position in 2015. (WIPO 2015) Regarding entrepreneurship, Hungary takes the 47th position globally on the Global Entrepreneurship and Development Index in 2017. (GEDI 2017) This is the 24th position out of the 28 EU Member States, which clearly reflects the relatively low level of entrepreneurship in the country.

Table 6.
Main economic trends of Hungary

Indicators	2004	2005	2006	2007	2008	2009	2010
Population (million)	10.11	10.09	10.07	10.06	10.04	10.03	10.01
Total GDP (current prices, million EUR)	83.54	90.59	91.39	101.7	107.6	93.80	98.32
GDP per capita (Euro)	N/A	9,000	9,100	10,100	10,700	9,400	9,800
GDP per capita (EU28 = 100%)	n.d.a.	62	61	60	62	64	64
Unemployment rate (%)	6.1	7.2	7.5	7.4	7.8	10.0	11.2
FDI (GDP %)	4.4	7.0	6.6	2.9	4.1	1.6	1.7
Investment (% of GDP)	24.06	23.87	23.58	23.66	23.26	22.81	20.35

Indicators	2011	2012	2013	2014	2015	2016
Population (million)	9.98	9.93	9.91	9.88	9.86	9.83
Total GDP (current prices, million EUR)	100.8	99.08	101.5	105.0	110,0	112.4
GDP per capita (Euro)	10,100	10,000	10,300	10,600	11,100	11,500
GDP per capita (EU28 = 100%)	66	65	67	68	68	67
Unemployment rate (%)	11.0	11.0	10.2	7.7	6.8	5.1
FDI (GDP %)	4.2	11.1	N/A	N/A	N/A	N/A
Investment (% of GDP)	19.77	19.36	20.94	21.80	21.67	N/A

Source: Compiled by the author based on Eurostat 2017b; 2017 c; 2017 d; 2017e and KSH[4] 2018a; 2018b.

As for infrastructure, there is a clear and unquestionable advancement in the field of both the quality and quantity of infrastructure in Hungary. Road density, accessibility, the quality of roads and railway networks have largely developed since 2004. There is a significant development actually in all main indicators of these fields: length of motorways, population connected to public water supply, urban wastewater treatment plants, population connected to wastewater treatment plants, sewage sludge production and disposal, share of renewable energy in gross final energy consumption (Table 7).

Table 7.
Infrastructure and environmental statistics in Hungary

Indicators	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Length of motorways (kilometre)	761	859	1,065	1,157	1,274	1,273	1,477	1,516	1,515	1,562	1,577	1,621
Population connected to public water supply (%)	99.9	99.9	99.9	100	100	100	100	100	100	100	100	100
Population connected to waste-water treatment plants (%)	72.1	60.6	63.4	66.5	67.7	68.8	71.7	72.3	72.9	72.7	73.8	76.8

[4] KSH: Központi Statisztikai Hivatal (en – Hungarian Central Statistical Office).

Indicators	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Share of renewable energy in gross final energy consumption (%)	4.4	4.5	5.1	5.9	6.5	8	12.8	14	15.5	16.2	14.6	14.5

Source: Compiled by the author based on Eurostat 2017f; 2017g; 2018a; 2018b.

Since 2010, there is a positive tendency on the Hungarian labour market: employment rate increased to 66.5% by 2016 (the EU average was 67.1%). Unemployment rate was 4.9% at the end of 2016, which gave Hungary the 4th best position among EU Member States (the EU average was 8.2%). Another important issue to note is that the Hungarian labour market—at least in some segments—is getting more and more demand-driven, i.e. there is a lack of skilled and qualified labour force in some sectors of the economy. Also, emigration from Hungary has accelerated since 2007, causing shortages of young and skilled labour force in the Hungarian economy.

Social and territorial cohesion could be best measured using the Cohesion Indicators of the European Union. (Eurostat 2017h) The share of people at risk of poverty and social exclusion is 31% in Hungary. Life expectancy is 75.7 years, while persons aged 25–64 with tertiary education attainment are 21.1%. All these values are lagging behind the EU average. On the Regional Social Progress Index, (European Commission) Hungarian regions got moderate scores, again, they are in worst position than the EU's average (Table 8).

Table 8.

Regional Social Progress Index of Hungarian regions

Region Code	Regions in Hungary	European Union Regional Social Progress Index
HU10	Central Hungary [Közép-Magyarország]	59.42
HU21	Central Transdanubia [Közép-Dunántúl]	56.21
HU22	Western Transdanubia [Nyugat-Dunántúl]	57.83
HU23	Southern Transdanubia [Dél-Dunántúl]	55.52
HU31	Northern Hungary [Észak-Magyarország]	52.72
HU32	Northern Great Plain [Észak-Alföld]	53.98
HU33	Southern Great Plain [Dél-Alföld]	54.54

Source: EC 2016

Unfortunately, in spite of the significant investments by EU funds into the Hungarian regions, they are still lagging behind the EU average. Although per capita GDP per region increased since the country's EU accession, as well as indicators regarding infrastructural situation have got better, the relative position of Hungarian regions has worsened (Table 9).

Table 9.
Regional Competitiveness Index ranking of Hungarian regions

The regions of Hungary (NUTS name)	RCI 2013	RCI 2016
Central Hungary [Közép-Magyarország]	144	152
Central Transdanubia [Közép-Dunántúl]	192	205
Western Transdanubia [Nyugat-Dunántúl]	189	207
Southern Transdanubia [Dél-Dunántúl]	219	227
Northern Hungary [Észak-Magyarország]	218	231
Northern Great Plain [Észak-Alföld]	231	232
Southern Great Plain [Dél-Alföld]	220	224

Source: EC 2016

Finally, it is important to look at the progress of Hungary in the fulfilment of the EU 2020 objectives of the European Union. Hungary is doing better in employment than the EU average, but lagging behind in Research and Development. Hungary's progress in the climate change and energy indicators is promising, just like in education (Table 10).

Table 10.
The EU 2020 objectives and their fulfilment in Hungary

EU 2020 objectives		Hungary's state of play (2016)	Hungary's target by 2020	EU average in 2016	EU 2020 targets
Employment	• 75% of people aged 20–64 to be in work	72.60%	75.00%	71.10%	75%
Research and development (R&D)	• 3% of the EU's GDP to be invested in R&D	1.40%	1.80%	2.10%	3%
Climate change and energy	• greenhouse gas emissions 20% lower than 1990 levels	16.20%	N/A	N/A	20%
	• 20% of energy coming from renewables	14.65%	14.65%	N/A	20%
	• 20% increase in energy efficiency	N/A	N/A	N/A	20%

EU 2020 objectives		Hungary's state of play (2016)	Hungary's target by 2020	EU average in 2016	EU 2020 targets
Education	• rates of early school leavers below 10%	12.50%	10.00%	10.70%	10%
	• at least 40% of people aged 30–34 having completed higher education	32.80%	34.00%	39%	40%
Poverty and social exclusion	• at least 20 million fewer people in – or at risk of – poverty/social exclusion	–13.80%	–20%	N/A	20 million

Source: Compiled by the author based on EC 2017; Eurostat 2018c.

Interdependence and Economic Penetration

Since Hungary's EU accession, trade and investment relations have intensified significantly. The volume of trade almost doubled in 10 years. Hungary has a positive trade balance with other countries of the EU (Table 11). The main export products of Hungary are automotive, machinery, other industrial products and food. The main import products are machinery, raw materials (energy) and food products. (Eurostat 2017i) The main export partners in the EU are Germany, Austria, Romania, Slovakia and Italy. The main import partners are Germany, China, Russia, Austria and Poland.

Table 11.
Trade values between Hungary and other EU Member States (million Euro, all products)

Indicators	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Exports	37,684	41,645	48,369	55,997	58,836	47,717	56,469	62,457	62,398	63,003	66,611
Imports	33,437	37,499	43,912	48,653	50,775	38,431	45,251	51,333	52,371	54,060	59,375
Trade balance	4,246	4,146	4,456	7,343	8,061	9,286	11,217	11,123	10,026	8,943	7,235

Source: Compiled by the author based on Eurostat 2017j.

As it can be seen on Figure 16, the value of export of Hungary has increased significantly since the mid-1990s. Figure 17 shows that export from Hungary to the EU28 (without Hungary EU27) countries showed a quick surge in the

second part of the 1990s, stabilising around 85% until 2004. Interestingly, after Hungary's EU accession, the share of export to the EU (in the total) started to decrease, although still has the dominant share (80%).

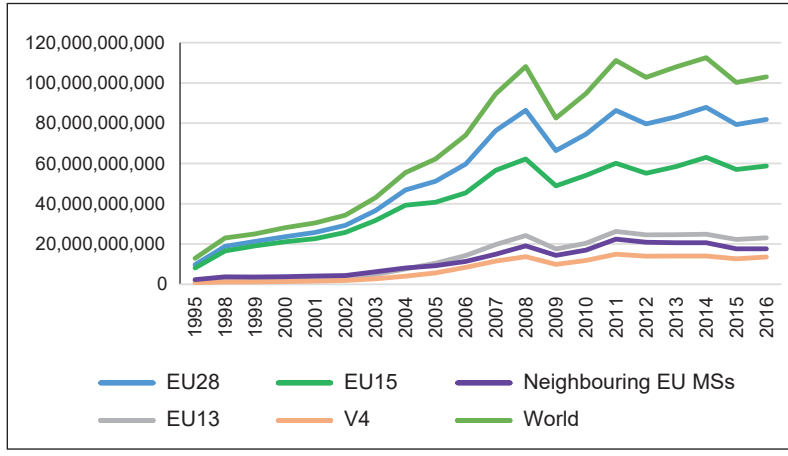

Figure 16.
The value of export of Hungary (USD)
Source: UN Comtrade 2016

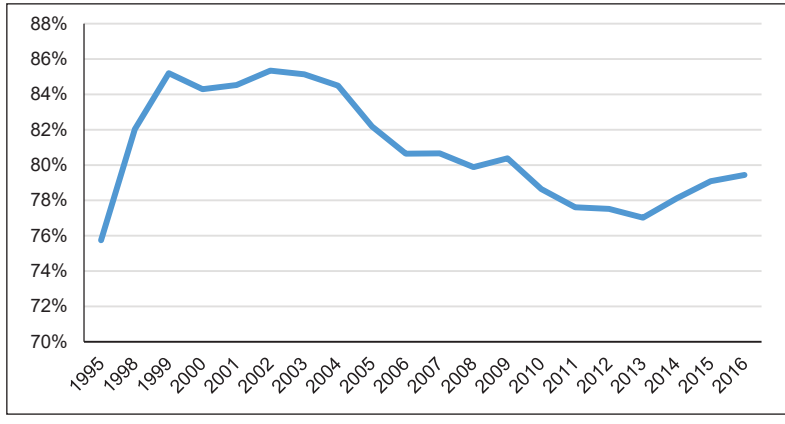

Figure 17.
Hungary's total EU export share (%)
Source: UN Comtrade 2016

Behind the above tendency, as we could see on Figure 18, Hungary's export to EU15 Member States is slowly but gradually decreasing, while the export to new Member States (EU13), including the Visegrád countries is on an upward trend.

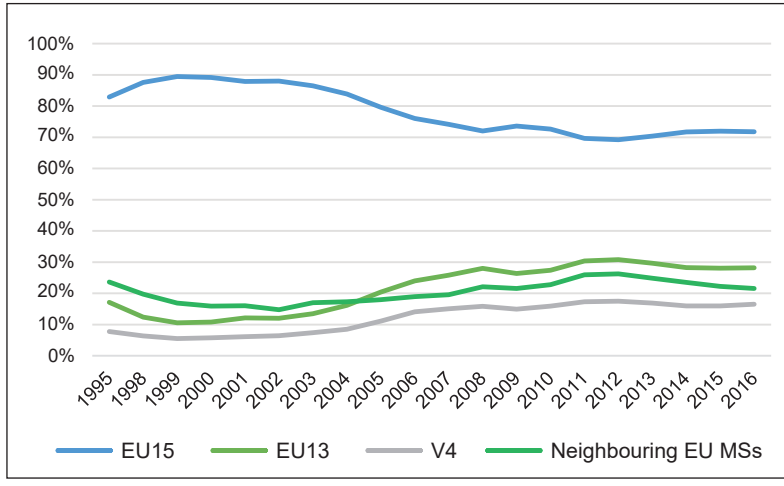

Figure 18.

Share of country groups in intra-EU Hungarian export (%)

Source: UN Comtrade 2016

This can be corroborated with Table 12. It shows that in approximately 20 years (1995–2016), Central and Eastern European (CEE) countries became more important export destinations to Hungary. Romania has been upgraded by 2016 compared to 1995, Slovakia became the third most important partner, while Poland and the Czech Republic are also in the top 10.

Table 12.
Hungary's main export partners in selected years

1995			2004			2016		
Member State	**Export value**	**Share in total export to EU MSs**	**Member State**	**Export value**	**Share in total export to EU MSs**	**Member State**	**Export value**	**Share in total export to EU MSs**
Germany	3,686,764,000	37.8%	Germany	17,539,824,000	37.4%	Germany	28,351,204,571	34.6%
Austria	1,303,271,000	13.4%	Austria	4,010,035,000	8.6%	Romania	5,144,974,646	6.3%
Italy	1,096,275,000	11.2%	United Kingdom	3,097,250,000	6.6%	Slovakia	5,069,365,532	6.2%
France	517,854,000	5.3%	France	3,090,910,000	6.6%	France	4,921,381,403	6.0%
United Kingdom	391,497,000	4.0%	Italy	3,053,520,000	6.5%	Italy	4,906,541,070	6.0%
Netherlands	374,897,000	3.8%	Netherlands	2,030,500,000	4.3%	Austria	4,894,258,905	6.0%
Romania	357,451,000	3.7%	Romania	1,747,824,000	3.7%	Czech Republic	4,266,810,195	5.2%
Poland	337,140,000	3.5%	Poland	1,593,090,000	3.4%	Poland	4,196,628,136	5.1%
Belgium	273,388,000	2.8%	Spain	1,548,522,000	3.3%	United Kingdom	4,026,080,618	4.9%
Slovenia	255,214,000	2.6%	Czech Republic	1,323,205,000	2.8%	Netherlands	3,248,909,216	4.0%

Source: UN Comtrade 2016

Similar tendencies can be observed based on Hungary's import relations. Hungary's main partners are EU countries, with a growing share and importance of new Member States (EU13) (Figure 19).

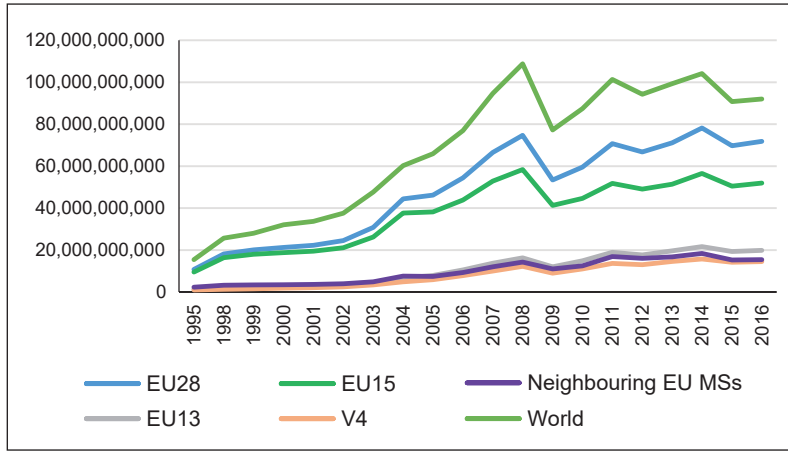

Figure 19.
The value of import of Hungary (USD)
Source: UN Comtrade 2016

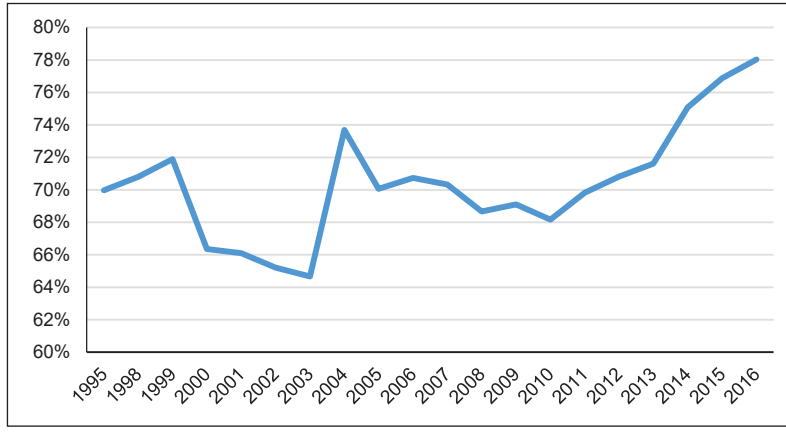

Figure 20.
Hungary's total EU import share (%)
Source: UN Comtrade 2016

Figure 20 shows that Hungary's import dependency on the EU is lower than that of export to the EU. Approximately 70% of all the import comes from EU Member States. In addition, Figure 21 and Table 13 confirm the growing importance of CEE countries in Hungary's import relations. This tendency is similar to that of the export relations. Poland, Slovakia, the Czech Republic and Romania can be found in the top 10 import partners of Hungary, with the unquestionable dominance of Germany and Austria through the last 20 years.

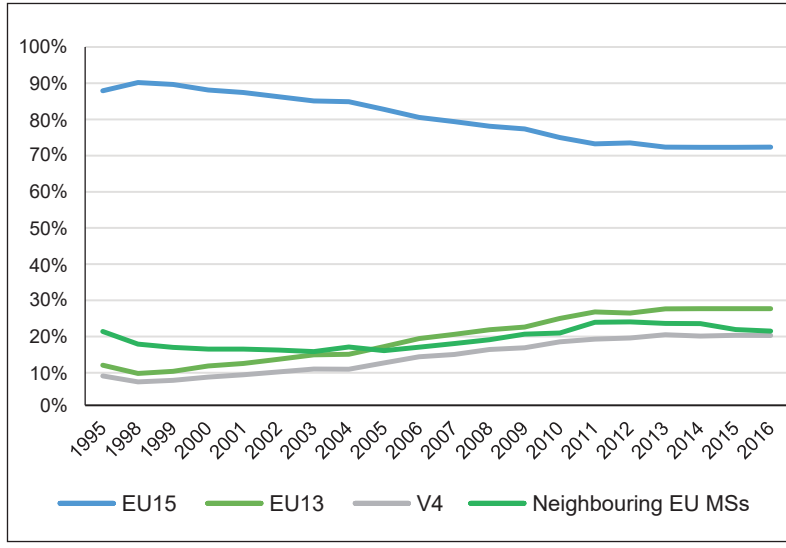

Figure 21.

Share of country groups in intra-EU Hungarian import (%)

Source: UN Comtrade 2016

Table 13.
Hungary's main import partners in the EU

1995			2004			2016		
Member State	**Import value**	**Share in total import from EU MSs**	**Member State**	**Import value**	**Share in total import from EU MSs**	**Member State**	**Import value**	**Share in total import from EU MSs**
Germany	3,628,234,000	33.5%	Germany	17,678,363,000	39.8%	Germany	24,343,945,038	33.9%
Austria	1,663,721,000	15.4%	Austria	4,901,052,000	11.0%	Austria	5,890,425,422	8.2%
Italy	1,220,388,000	11.3%	Italy	3,377,489,000	7.6%	Poland	5,115,600,894	7.1%
France	610,747,000	5.6%	Netherlands	2,974,453,000	6.7%	Slovakia	4,908,774,501	6.8%
Netherlands	483,651,000	4.5%	France	2,776,299,000	6.3%	Czech Republic	4,528,783,025	6.3%
United Kingdom	476,470,000	4.4%	Poland	1,944,139,000	4.4%	Netherlands	4,512,370,900	6.3%
Belgium	391,457,000	3.6%	Czech Republic	1,723,855,000	3.9%	France	4,491,984,397	6.3%
Slovakia	369,703,000	3.4%	United Kingdom	1,614,142,000	3.6%	Italy	4,429,607,015	6.2%
Czech Republic	363,995,000	3.4%	Belgium	1,250,549,000	2.8%	Romania	2,824,796,930	3.9%
Sweden	311,422,000	2.9%	Slovakia	1,204,973,000	2.7%	Belgium	2,148,772,489	3.0%

Source: UN Comtrade 2016

Regarding the Foreign Direct Investments, we could also see a significant increase both in terms of Hungarian FDI stock in other EU Member States as well as FDI inflow to Hungary (Table 14). FDI in Hungary has flown into the banking sector and automotive industry. Hungarian outward FDI primarily has flown into the financial sector. We can conclude that strong trade and investment relations between Hungary and other EU Member States clearly show how embedded and connected the Hungarian economy to the EU economy is.

Table 14.

FDI values between Hungary and other EU Member States (million EUR)

Indicators	2004	2005	2006	2007	2008	2009	2010	2011	2012
Direct investment stock, EU27	3,100	4,410	5,737	7,507	6,678	6,035	5,269	7,286	11,876
Direct investment inward flow from EU27	2,067	5,909	5,015	2,342	4,197	–3,242	753	3,756	8,607

Source: OECD 2013

As we described above, economic integration and connectedness could be greatly expressed by capital flows. Foreign Direct Investment statistics shows that Hungary's EU accession was a boost to inward and outward FDI, as well. Both the economic transition in the early 1990s and the EU accession contributed to the intensification of capital flows regarding Hungary (Figure 22 and 23).

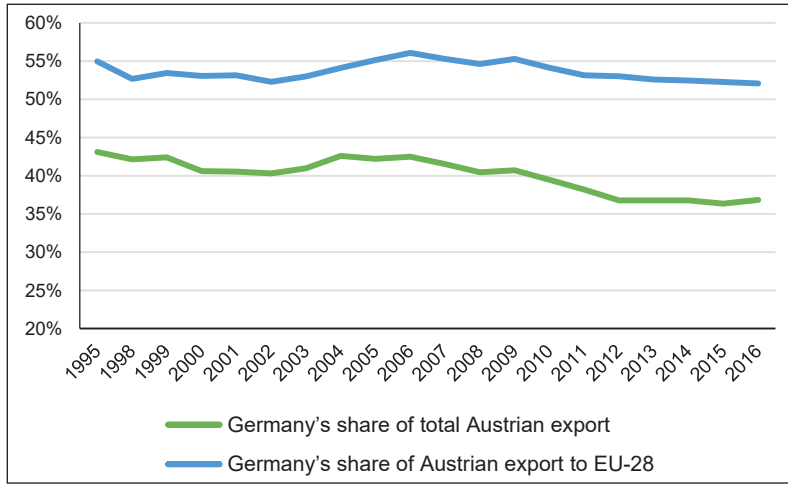

Figure 22.
Foreign Direct Investment inflow, Hungary

Source: WB 2017a

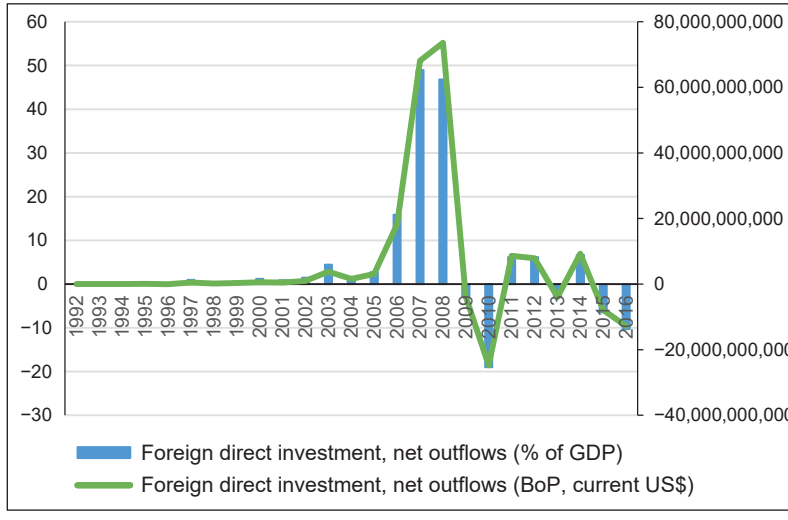

Figure 23.
Foreign Direct Investment outflow, Hungary

Source: WB 2017b

The Economic Complexity Index (ECI) also expresses a country's capability and prospects to integrate into the global economy. Theoretically speaking, ECI measures the knowledge intensity of an economy by considering the knowledge intensity of the products it exports. ECI can be used to construct relative measures of the knowledge intensity of economies. ECI has been validated as a relevant economic measure by showing its ability to predict future economic growth. We can observe a positive tendency in Hungary regarding this index, as its value has generally been improving in the last almost 30 years (Figure 24). The index increased more before Hungary's EU accession (2004), as this was the period of radical economic change in the country, economic restructuring, significant change in the ownership of production facilities, all this combined with the orientation of foreign markets, building up an export-driven economy with the involvement of foreign direct investment. In the period of Hungary's EU membership, the value of the index remained fundamentally unchanged with smaller volatilities. This means that Hungary's economic structure has been prepared and adjusted to the needs of the EU market—to which it is mostly integrated—and since then the Hungarian economy is "only" fulfilling the expectations of this market, there is no pressure for change and further diversification at this moment.

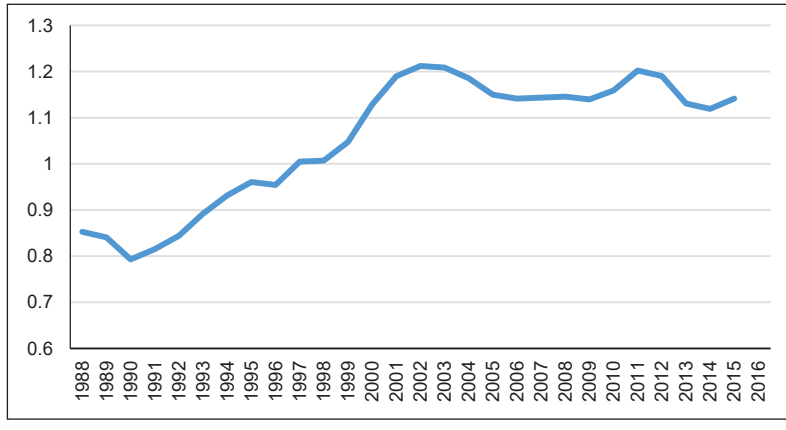

Figure 24.
Economic Complexity Index in Hungary

Source: OEC[5] 2016

[5] OEC: The Observatory of Economic Complexity.

Globalisation indices express a country's involvement and integratedness into the global economy and society by quantifying and analysing the economic, political and social ties of the country to other countries. The KOF Globalization Index shows the picture of a gradually integrated Hungary into global economic, social and political relations (Figure 25). We can see that from the late 1980s until 2004—the country's EU accession—the value of the index for Hungary is increasing. Since 2004, there is a "stagnation" and slight increase.

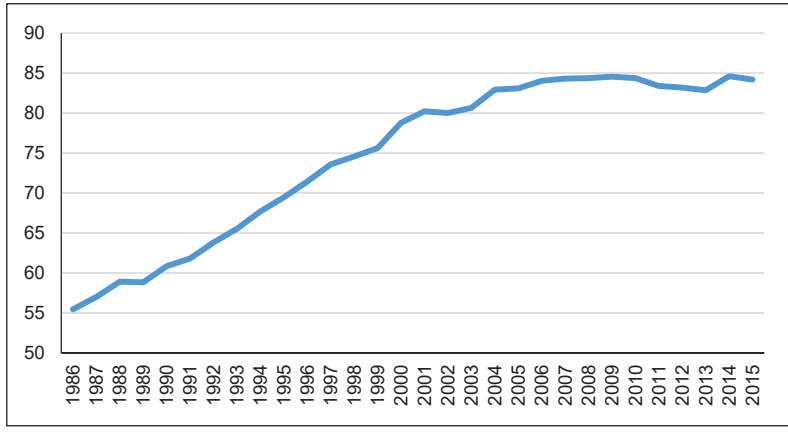

Figure 25.
KOF Globalization Index, Hungary

Source: ETHZ[6] 2015

The DHL Global Connectedness Index shows fundamentally the same tendency. Hungary's ranking has gradually improved in the last more than 10 years. The country is ranked among the top 15 most connected countries in the world (Figure 26).

[6] ETHZ: ETH Zürich.

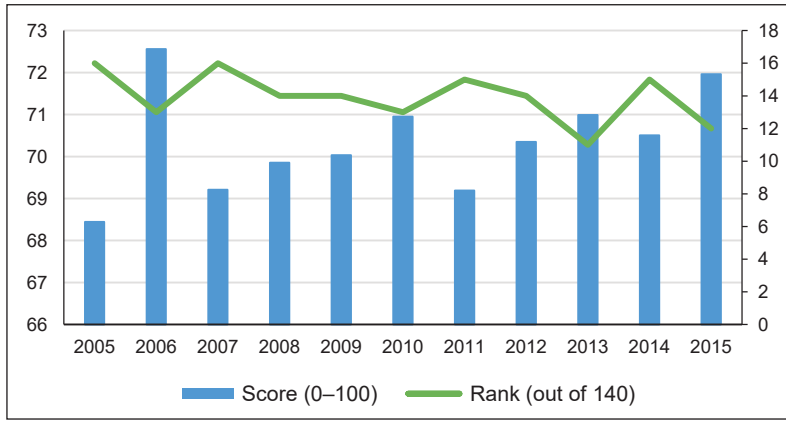

Figure 26.
DHL Global Connectedness Index, Hungary

Source: DHL 2015

Conclusion and Outlook: Drawing the Balance of the Results of Integration

In the triangle of economic transformation, economic integration and economic dependency, we can draw some key conclusions regarding Hungary. These are the following:

- Hungary's economic transformation was a gradual process, which has intensified in the late 1980s and took dominantly place in the 1990s. By 2000, the economic transformation practically has been completed with a dominantly privately owned economy with significant foreign ownership;
- foreign direct investment played a key role in the economic transformation and foreign capital has a dominant role in today's economy in Hungary both in terms of contribution to GDP, employment and export;
- in line with the growing foreign ownership in the Hungarian manufacturing sector, Hungary's trade reorientation is a success story. The former relations with the countries of the Soviet bloc have been replaced by the deep trade relations to the Western European countries. Both in FDI and trade, Hungary's main partners are Germany and Austria;

- export to EU Member States has the most significant part of Hungary's export relations. Although the dominant share of it is attributed to EU15 Member States, export to new Member States (EU13) play a more and more important role. Interestingly, Hungary's EU accession helped integrate the Hungarian economy not only to old Member States (it was already integrated to them before 2004), but more to Central and Eastern European Member States;
- recent years have seen a growing level of outward FDI from Hungary. Investments of Hungarian companies are targeting the Visegrád counties, Balkan countries and the post-Soviet region;
- Hungary is a net beneficiary country of the European Union, getting on average almost 3% of its Gross National Income since the country's EU accession. These funds significantly contributed to the development of Hungary in the last more than 10 years. Nevertheless, it also caused dependency to the EU budget (the net contributor Member States); today, most of the new investments in the country are EU co-funded. Nevertheless, in spite of significant funding, Hungary is still lagging behind in social and territorial cohesion;
- Hungary's gradual integration into the global economy as well as the global political and social tendencies are confirmed by the globalisation indices. The country's global rankings have improved in the last 15–20 years.

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Vákát oldal

Chapter 5.

Economic Integration and Interdependence in Poland

Fast Success?

Barbara Wieliczko

The Conditions at the Beginning of the Integration Process

The state of the Polish economy at the verge of the systemic transformation was in recession. In 1989, the consumer price index reached 251.1%. The economy was in poor shape due to the input shortages related to inflation. The elections conducted under the agreement signed after the round table discussions made the changes in the economic system possible, so the government of Prime Minister Mazowiecki could start the changes that was hoped to bring a total change in the functioning of the economy which was to ensure a much higher quality of life.

The transformation process of the Polish system started in 1989, when the parliament accepted the reform package known as the Balcerowicz Plan after its main proponent and implementer who was a minister of finance and deputy prime minister. The Plan was aimed at the transformation of the Polish economy from central planning to market economy. The Plan included 10 acts. These are related to, among others, the following issues:

- removing the guarantee of existence of all state-owned enterprises, thus enabling bankruptcy proceedings against unprofitable enterprises;
- prohibiting the financing of the budget deficit by the central bank, which made it impossible to issue unlimited funds without coverage;
- abolishing credit preferences of state-owned enterprises by binding the interest rate with the inflation rate – this changed the terms of previously concluded credit agreements with a fixed interest rate;

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- introducing special tax on remuneration growth so as to limit the growth of inflation;
- implementing rules on conducting economic activity;
- unifying tax regulation irrespective of the type of ownership of companies. (Wikipedia s. a.)

These acts enabled the transformation of the Polish economy from the centrally planned one into the market one. This included changes in the structure of ownership, opening the economy, shaping conditions for competition and creating capital and labour market.

The implementation of the Plan was considered a shock therapy as the changes were fast and profound. The figures show that it was effective in stabilising the economy. However, the transformation process and the privatisation linked to it led to the appearance of unemployment, a phenomenon not known in a centrally planned economy. Unemployment grew rapidly to a high figure. Moreover, the tax on increasing remuneration in the context of high inflation was seen as the reason for too strong fall in the life standard of numerous groups of citizens. Therefore, the social costs are seen by some experts too high. (Rolski 2013)

The reforms conducted in the first years of the transformation soon put Poland on the GDP growth path. The structure of the economy and the direction of the Polish export changed significantly. Germany became the key economic partner and Poland's economic situation started to be correlated with the German one. Germany also became the most important investor in Poland. Foreign direct investment played a vital role in speeding up the structural changes and the increase of labour productivity.

Interdependence and Economic Penetration

The Polish economy had to struggle not only with inner economic problems in its transformation process, but it was also faced with the collapse of its exports markets as the Soviet bloc, its chief buyer, heeded into recession and political turmoil. The export markets were closed due to the problems of the socialist economies. The Polish economy had to change its exporting orientation which came at a cost to former export leaders and took some time. The biggest loser of the changes was the heavy industry. The problems of

this sector were so immense that most of the companies had to close down which led to a rapid and significant growth of unemployment.

After the beginning of the transformation process, foreign direct investment in Poland exceeded PLN 712 billion. (Czerniak–Blauth 2017) The key foreign investors were the EU and the USA. Foreign capital increased the productivity of the Polish economy by introducing modern technologies. The added value of the companies acquired by foreign owners was increased by 2.2% annually more than other entities. (Czerniak–Blauth 2017) Foreign Direct Investment (FDI) also contributed to the development of the Polish economy. Demand generated by it amounted to 3% of the GDP. It also positively influenced labour productivity, the level of remuneration and employment. It is vital to emphasise that the share of foreign companies in the Polish export amounts to 67.1%. (Czerniak–Blauth 2017) This shows their importance in shaping the Polish trade balance.

The changes in ownership structure were first and foremost the result of the opening of the Polish market and the need to modernise it. Therefore, with the lack of internal funds and investors, foreign ones were more than welcomed. Naturally, the closer cooperation with more developed countries and international organisations led to further changes in regulations concerning foreign investments. Moreover, the growing economy ensured a satisfactory level of legal and political stability. Foreign companies played the most important role in restructuring the Polish banking sector. In 1999, due to OECD membership and EU accession negotiations, most of the limitations to the foreign banks presence in Poland was lifted which resulted in a quick transformation of the sector. Currently, approximately 70% of it is owned by foreign investors. (Siemiątkowski 2011) Until 2003, the annual value of funds withdrawn from Poland did not exceed several thousand USD, but later it started to grow reaching a record level of USD 9 billion in 2009. (Siemiątkowski 2011) As for the incomes of foreign investors in Poland, in 2016 they reached a record level of almost EUR 18.8 billion. (Eurostat 2017) This meant that every EUR 100 invested brought EUR 8.4. After 2007, also the rate of the reinvestment was a record one reaching 3.8%. (Eurostat 2017)

Poland is the biggest of the European former socialist bloc countries bordering Germany. Therefore, the most important economic advantage Poland can offer to investors and companies is the size of the Polish market and proximity to the EU15 markets. Still, as from the beginning of the transformation process, an important attracting factor is skilled and cheaper labour

force than in EU15. Since the Polish EU accession, the Polish FDI inward position has been oscillating around 1/3 of the GDP (Table 1). A significant fall was observed in 2008 in the middle of the financial crisis. The Polish FDI outward position is much lower compared with the inward one, but it increased significantly in the last decade.

Table 1.

Polish FDI position in the period of 2005–2016

Specification	FDI outward position	FDI inward position	FDI outward position	FDI inward position
	in USD millions		as a share of GDP	
2005	1,776	86,338	0.6	28.2
2006	4,402	115,796	1.3	33.6
2007	7,280	164,377	1.7	38.3
2008	8,204	148,402	1.5	27.8
2009	11,503	167,381	2.6	38.1
2010	16,407	187,602	3.4	39.1
2011	18,928	164,424	3.6	31.1
2012	26,102	198,953	5.2	39.8
2013	27,725	229,167	5.3	43.7
2014	21,797	211,951	4.0	38.9
2015	22,281	183,869	4.7	38.5
2016	27,076	185,042	5.8	39.4

Source: Compiled by the author based on OECD 2018.

An important issue related to the interdependence in case of Poland is the export. Until the end of the1980s, the key destination for the Polish exports was the Soviet Union. After it collapsed and the countries of the Soviet bloc were suffering an economic crisis, Poland had to find new markets for its goods. Already in 1990, Germany has gained the position of the first Polish trade partner and it has kept it ever since. Germany's share in the Polish export fluctuated between 25%–30% in the period of 2004–2017 (Table 2). In fact Germany does not only occupy the first position in the Polish export, but its share is over 4 times larger than the country's in the second position. Yet, it is not only Germany that is vital for the Polish export. When looking at the ten countries that have the highest share in the Polish export, it is clearly visible that it depends on the EU countries. The only non-EU countries that during the period of 2004–2017 made it to the list of ten key Polish export destinations more than once were Ukraine and Russia. The EU related Polish

export accounts for approximately 75% of the Polish export. This shows the importance of the EU to Poland and the dependence of the Polish economy on the situation in the EU and especially in Germany.

Table 2.

Most important Polish export destinations in the period of 2004–2017 and their share in the Polish export (%)

Year/ Position	1	2	3	4	5
2004	Germany	Italy	France	United Kingdom	Czech Republic
	30.05	6.12	6.05	5.41	4.32
2005	Germany	France	Italy	United Kingdom	Czech Republic
	28.20	6.21	6.13	5.58	4.57
2006	Germany	Italy	France	United Kingdom	Czech Republic
	27.15	6.53	6.24	5.71	5.54
2007	Germany	Italy	France	United Kingdom	Czech Republic
	25.90	6.61	6.09	5.94	5.54
2008	Germany	France	Italy	United Kingdom	Czech Republic
	25.04	6.21	5.98	5.77	5.70
2009	Germany	France	Italy	United Kingdom	Czech Republic
	26.15	6.94	6.86	6.40	5.84
2010	Germany	France	United Kingdom	Czech Republic	Italy
	26.10	6.77	6.28	5.98	5.93
2011	Germany	United Kingdom	Czech Republic	France	Italy
	26.09	6.45	6.23	6.12	5.32
2012	Germany	United Kingdom	Czech Republic	France	Russia
	25.15	6.77	6.32	5.87	5.35
2013	Germany	United Kingdom	Czech Republic	France	Russia
	25.09	6.50	6.19	5.61	5.26
2014	Germany	Czech Republic	United Kingdom	France	Italy
	26.31	6.47	6.37	5.59	4.54
2015	Germany	United Kingdom	Czech Republic	France	Italy
	27.11	6.74	6.64	5.54	4.84
2016	Germany	United Kingdom	Czech Republic	France	Italy
	27.38	6.65	6.57	5.50	4.77
2017	Germany	Czech Republic	United Kingdom	France	Italy
	27.41	6.40	6.37	5.62	4.91

Year/ Position	6	7	8	9	10
2004	Netherlands	Russia	Sweden	Belgium	Ukraine
	4.30	3.82	3.51	3.20	2.74
2005	Russia	Netherlands	Sweden	Belgium	Ukraine
	4.44	4.16	3.08	2.98	2.91
2006	Russia	Netherlands	Ukraine	Sweden	Hungary
	4.28	3.85	3.60	3.21	3.04
2007	Russia	Ukraine	Netherlands	Sweden	Hungary
	4.62	3.96	3.83	3.22	2.91
2008	Russia	Netherlands	Ukraine	Sweden	Hungary
	5.20	4.03	3.72	3.17	2.77
2009	Netherlands	Russia	Hungary	Sweden	Spain
	4.21	3.67	2.70	2.68	2.6
2010	Netherlands	Russia	Sweden	Hungary	Slovakia
	4.38	4.19	2.96	2.83	2.70
2011	Russia	Netherlands	Sweden	Hungary	Ukraine
	4.49	4.37	2.85	2.56	2.48
2012	Italy	Netherlands	Ukraine	Sweden	Slovakia
	4.85	4.48	2.85	2.68	2.59
2013	Italy	Netherlands	Ukraine	Sweden	Slovakia
	4.32	3.97	2.78	2.71	2.64
2014	Russia	Netherlands	Sweden	Hungary	Slovakia
	4.23	4.16	2.84	2.63	2.54
2015	Netherlands	Russia	Sweden	Hungary	Spain
	4.43	2.85	2.74	2.66	2.62
2016	Netherlands	Sweden	Russia	Spain	Hungary
	4.48	2.90	2.82	2.72	2.65
2017	Netherlands	Russia	Sweden	Spain	United States
	4.39	3.03	2.77	2.72	2.69

Source: Compiled by the author based on GUS[7] s. a.

Poland has a positive trade balance with the EU as a whole. EU countries are more important for Poland as export destinations than as a source of imports. The EU's share in the Polish imports was stable in the period of 2002–2016 and amounted to approximately 60%, while its share in exports increased significantly (Table 3).

[7] GUS: Główny Urząd Statystyczny (en – Statistics Poland).

Table 3.
The EU's share in the Polish imports and exports in the years 2002–2016

Year	Imports	Exports
2002	61.7	68.7
2003	61.1	68.8
2004	68.3	79.2
2005	65.6	77.2
2006	63.2	77.4
2007	64.2	78.9
2008	61.9	77.8
2009	61.9	79.6
2010	59.5	79.1
2011	59.6	78.0
2012	57.5	76.1
2013	58.4	74.8
2014	59.0	77.5
2015	60.0	79.4
2016	61.2	79.8

Source: Compiled by the author based on the data of GUS 2007; 2010; 2012a; 2017.

Foreign direct investment has been important for Poland's development ever since the beginning of the transformation. The scale of FDI coming to Poland was fluctuating in the period of 2000–2016 (Table 4). The structure of FDI changed. In recent years, reinvestment of profits has become the most important part of FDI. This shows a growing involvement of companies that invested in Poland and thus, a growing interdependence.

Table 4.
Amount of FDI coming to Poland in the period of 2000–2016 (in million EUR)

Year	Shares and other forms of equity	Reinvestment of profits	Debt instruments	Total
2000	9,666	–434	1,002	10,234
2001	5,908	–1,161	1,480	6,226
2002	4,521	–1,294	1,038	4,265
2003	4,032	–75	–436	3,522
2004	5,972	4,989	–925	10,036
2005	3,595	2,717	1,499	7,812
2006	5,741	4,530	4,373	14,644
2007	5,592	6,770	3,474	15,836
2008	6,712	–654	3,440	9,497
2009	3,804	3,581	1,187	8,572
2010	3,148	5,620	891	9,659
2011	1,483	5,236	6,412	13,131
2012	–1,153	4,362	2,331	5,540
2013	–5,447	4,124	3,531	2,208
2014	3,324	6,485	1,444	11,253
2015	5,470	7,286	1,635	14,391
2016	2,107	8,556	3,066	13,729

Source: Compiled by the author based on the data of NBP[8] 2013–2018.

This interdependence is especially related to EU countries as their share in the amount of FDI in recent years amounted to at least approximately 90% of the total amount (Table 5). The key investor countries are Germany, France and the Netherlands.

[8] NBP: Narodowy Bank Polski (en – National Bank of Poland).

Table 5.
The share of the EU in FDI coming to Poland in the period of 2011–2016 (% of total)

Year	Share
2011	122.8[9]
2012	86.6
2013	183.5
2014	108.1
2015	92.5
2016	91.9

Source: Compiled by the author based on the data of NBP 2013–2018.

The Use of EU Funds

Poland, as other states which have become EU members since 2004, benefited from EU pre-accession support. The support included the following funds: PHARE, ISPA and SAPARD. The first pre-accession fund was PHARE. The operation of the programme started in 1990. The fund's support covered a wide range of sectors and problems as PHARE was aimed at supporting the process of reforms in transition countries. Poland was the largest beneficiary of PHARE funds. It received EUR 3,994.1 million out of EUR 18,673.1 million targeted at the candidate countries covered by this support in the period of 1990–2006. According to the fund's ex-post evaluation "[I]mplementation of Phare in Poland is considered generally successful in the areas such as environment and internal market, where Phare funds and projects provide notable value added. In some limited cases remedial actions had to be taken. Some sectors remain problematic, such as transport, and agriculture, where several remedial actions had to be taken

[9] The share can be higher than 100% when there is an outflow of investments by other investors.

to decrease the negative impact from excessive delays, avoid the risk of loss of funds and support Poland's ability to fulfil the acquis in these areas". (Business and Strategies Europe 2015, 40) Instrument for Pre-accession Assistance (ISPA) was a pre-accession fund directed to transport and environmental infrastructure in candidate countries. It operated on the principles valid for the Cohesion Fund. The funds that approximately had EUR 350 million a year, were equally divided between the two priorities. The SAPARD programme was especially important for the processing industry. It launched an accelerated process of upgrading technology that led to growth in competitiveness and enabled successful competition at the single EU market. The largest share of SAPARD funds in Poland was devoted to the implementation of local community infrastructure projects in rural areas (45%). Further 34% of funds were allocated to the investment projects implemented by the agri-food undertakings, whereas the largest number of projects (about 13 thousand) included activities carried out on agricultural holdings. Currently, Poland is the largest beneficiary of the EU funds. The value of the 2004–2006 allocation for Poland constituted 6% of the whole funds within the EU Cohesion Policy for 2000–2006 and almost half of the funds earmarked for Member States which joined the EU in 2004. In the financial perspective between 2007–2013 Poland became the key beneficiary of the EU funds of all Member States receiving nearly one fifths of the available resources (EUR 67.3 billion). For the period of 2014–2020, it was allocated EUR 82.5 billion to the country. Since the EU accession, Poland has received over EUR 96 billion (EU transfers minus Polish contributions to the EU budget). The funds received cover the whole spectrum of EU policy instruments applied to the EU member states in this period (Tables 6 and 7).

Table 6.
Transfers of funds between EU and Poland in the years 2004–2010 (in EUR)

Specification	2004	2005	2006	2007	2008	2009	2010
PHARE	364,746,112	333,107,462	222,280,250	855,992	0	0	0
SAPARD	118,293,459	339,076,932	12,481	0	34,716,263	0	0
ISPA	209,177,700	229,083,394	265,031,136	352,620,317	339,577,874	153,175,501	108,459,104
Cohesion Fund	0	0	255,730,261	939,736,508	1,332,079,814	2,269,217,223	2,163,929,765
Structural funds	840,975,083	775,489,907	1,624,939,595	3,448,257,787	3,446,708,115	3,726,732,940	5,377,936,911
Direct payments	0	702,674,035	811,580,923	935,100,872	1,037,600,783	1,446,164,527	1,827,719,773
Rural development	286,640,000	662,100,658	1,149,555,478	1,550,886,535	846,530,427	1,043,825,682	1,571,940,488
Other agricultural support	10,786,208	177,306,955	192,996,993	67,695,146	147,029,790	423,941,485	78,960,948
Transition facility		10,345,174	25,560,724	33,730,473	16,761,542	7,799,641	0
Liquidity instrument	490,295,800	612,043,968	514,292,712	0	0	0	0
Schengen Facility	103,351,872	103,858,296	106,664,337	0	0	0	0
European Fisheries Fund					51,386,780	51,386,480	37,168,509
Migration funds	0	0	0	0	4,477,021	13,770,764	7,770,129
Other transfers	53,365,000	72,968,000	100,204,257	77,341,966	139,503,999	122,426,450	52,031,380
Total	2,477,631,234	4,018,054,781	5,268,849,147	7,406,225,595	7,396,372,407	9,258,440,695	11,229,303,573
Polish contribution to the EU budget	1,318,979,881	2,379,384,673	2,552,450,098	2,779,298,358	3,402,108,330	3,233,746,572	3,489,951,756
Funds returned	0	22,969,276	4,046,130	45,064,096	7,826,157	12,787,124	1,758,255
Balance	1,158,651,353	1,615,700,832	2,712,352,921	4,581,863,142	3,986,437,920	6,011,906,999	7,737,593,561

Source: Compiled by the author based on MF[10] s. a.

[10] MF: Ministerstwo Finansów (en – [Polish] Ministry of Finance).

Table 7.
Transfers of funds between EU and Poland in the years 2011–2017 (in EUR)

Specification	2011	2012	2013	2014	2015	2016	2017
ISPA	79,724,373	24,082,951	77,888,836	54,857,443	67,888,577	0	0
Cohesion Fund	2,610,487,227	3,174,473,034	3,482,716,144	4,524,540,951	3,811,899,196	2,354,729,836	2,580,002,961
Structural funds	7,114,227,955	7,270,509,259	7,050,935,433	7,369,627,734	4,053,176,811	2,768,849,039	4,448,542,797
Direct payments	2,395,415,615	2,702,781,649	3,065,995,810	3,154,051,235	3,375,509,410	3,230,960,593	3,313,227,469
Rural development	1,706,015,707	2,024,767,952	1,695,969,389	1,772,534,433	1,428,311,511	1,048,087,364	563,738,811
Other agricultural support	153,794,174	140,706,620	121,065,117	49,677,912	93,332,694	204,553,331	101888118
European Fisheries Fund	71,086,297	63,019,618	116,130,229	132,430,236	160,835,711	38,911,700	3,120,914
Migration funds	9,071,680	19,812,579	19,247,433	8,181,820	16,591,144	51,188,853	10,989,635
Fund for European Aid to the Most Deprived	N/A	N/A	N/A	52,069,519	N/A	57,012,302	49,411,199
Connecting Europe Facility	N/A	N/A	N/A	N/A	36,284,733	213,413,802	69,780,777
Other transfers	130,804,727	19,827,909	5,708,889	6,631,360	10,355,371	8,724,470	11,902,708
Total	14,270,627,754	15,439,981,570	15,635,657,282	17,124,602,643	13,054,185,157	9,976,431,291	11,152,605,388
Polish contribution to the EU budget	3,733,869,437	3,568,719,480	4,439,022,479	4,153,101,502	4,262,068,238	4,493,369,548	3,557,347,001
Funds returned	44,441,271	1,634,227	1,489,218	1,237,753	7,727,673	1,389,807	2,074,821
Balance	10,492,317,046	11,869,627,863	11,195,145,586	12,970,263,389	8,784,389,246	5,481,671,935	7,593,183,566

Source: Compiled by the author based on MF s. a.

The structure of funds received by Poland corresponds with the EU policy and the development level of Poland. Therefore, over 20% of funds transferred to Poland were received from the Cohesion Fund (Figure 1). An important part of the EU support was distributed through the common agricultural policy (CAP) which accounted for approximately 1/3 of the funds allocated for Poland.

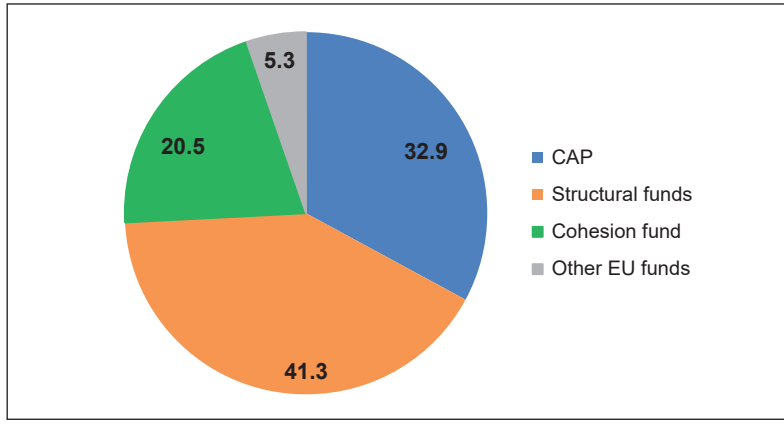

Figure 1.
Structure of EU funds received by Poland in the years 2004–2017
Source: Compiled by the author based on MF s. a.

In all the programming periods, the EU co-financed programmes had objectives directly related to the EU priorities. They were very general and fitted to all regions and activities in every programming period. Within regional operational programmes, the priorities were similar in all the regions and the regions' specific features were hardly visible.

The National Development Plan (NDP) was a document that stipulated the way EU funds were to be implemented in Poland in the programming period 2004–2006. (Rade Ministrów 2003) Its strategic goal was the development of competitiveness of the Polish economy that would enable increase in employment level and lasting sustainable development as well as improvement of social, economic and territorial cohesion with the EU (both at the regional and country level). The total amount of EU funds relating to NDP was EUR 12,800 million. The NDP encompassed the following programmes and instruments.

a) Community Support Framework, including:
- Integrated Operational Programme of Regional Development (European Regional Development Fund—EUR 2,530.4 million, European Social Fund—EUR 438.4 million);
- Sectoral Operational Programme for Development of Human Resources (EUR 1,470 million);
- Sectoral Operational Programme for Increase of Companies' Competitiveness (EUR 1,251.1 million);
- Sectoral Operational Programme for Transportation (EUR 1,163.4 million);
- Operational Programme for Technical Assistance (EUR 28.3 million);
- Sectoral Operational Programme "Restructuring and Modernisation of the Food and rural development" (EUR 1,192.7 million);
- Sectoral Operational Programme for Fisheries and Fish Processing (EUR 201.8 million).

b) Cohesion Fund—EUR 4,178.6 million, equally divided between transportation and environmental projects.

c) Community initiatives, including:
- EQUAL—promotion of gender equality (allocation—EUR 133.9 million);
- INTERREG III (together with neighbourhood programmes)—boarder, transnational and interregional economic co-operation (allocation—EUR 221.36 million).

In the programming period of 2007–2013, the amount of funds allocated to Poland was much higher than in the short programming period 2004–2006. Over 2/5 of the funds within the cohesion policy was allocated to the Operational Programme Infrastructure and Environment (Figure 2). A quarter of cohesion policy funds were allocated to regional programmes.

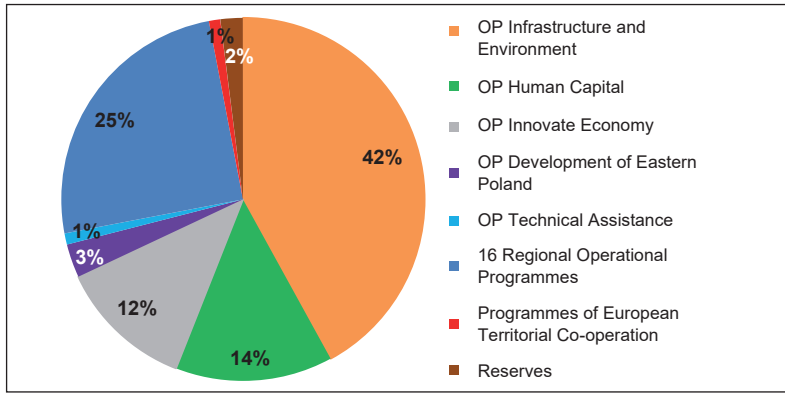

Figure 2.

Distribution of funds allocated to Poland under the cohesion policy between 2007–2013 according to Operational Programmes

Source: 2nd European Funds Forum 2009

In the programming period of 2007–2013, transport infrastructure continued to be a key priority for Poland (Figure 3). The second area with the largest share of funds allocated was research and innovation, followed by human capital and environmental protection.

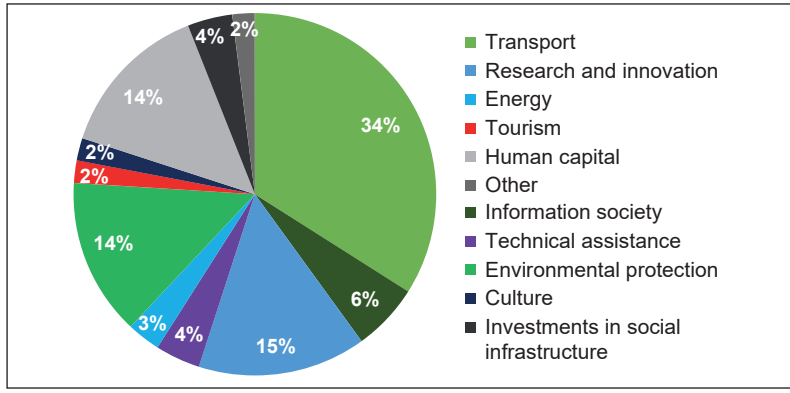

Figure 3.

Distribution of funds allocated to Poland under the cohesion policy between 2007–2013 according to support areas

Source: 2nd European Funds Forum 2009

In the programming period of 2014–2020, the amount of funds earmarked for Poland was even higher than in 2007–2014. It was divided between the following programmes (Figure 4):

- Infrastructure and Environment Programme: under this programme large enterprises will be able to obtain grants for investments in support of transition to low-emission economy, energy efficiency increase and use of renewable energy sources.
- Smart Growth Programme: oriented at development of innovation in Polish economy, mainly by stimulating research and development and transferring the results to the economy sector. This programme will let large enterprises develop innovative projects involving collaboration with scientific units in order to commercialise scientific research results, and will let increase the outlays on research and development in companies.
- Knowledge, Education, Growth Programme: under this programme, companies will be able to carry out projects involving training for employees so that the personnel competences and skills will be developed.
- Digital Poland Programme: addressed to the public sector. Telecommunications companies will receive funds for construction, extension or restructuring of broadband Internet access, and support for e-administration and e-services in collaboration with the local and central government administration. Furthermore, local government units can use this programme to implement tasks aiming at e-integration and e-activation to increase intensity and quality of the Internet use.
- Eastern Poland Programme: covers the Eastern macro-region including 5 provinces: lubelskie, podkarpackie, podlaskie, świętokrzyskie and warmińsko-mazurskie. Large companies may use this programme to obtain aid for research and development work, building and expanding R&D facilities, projects concerning eco-innovation and energy efficiency which would lead to innovation.
- Technical Assistance Programme: it is a tool to build the potential of institutions in charge of financial intervention.
- Regional Operational Programme: the aid under the Regional Operational Programme is distributed in line with the individual needs of the region. As a matter of principle, such investments should

complement national efforts on: popularising information and telecommunications technologies, research, technological development and innovation, infrastructure, environmental protection as well as energy and transport.

The responsibility for the distribution of EU funds in Poland is going to be shifted more to provinces. Significantly more funds are being managed through the Regional Operational Programmes focused on local and regional investments. Between 2007 and 2013, local governments handled about 25% of all funds for Poland, now they are in charge of almost 40%. Consequently, local governments have more freedom in choosing which growth targets they want to focus on.

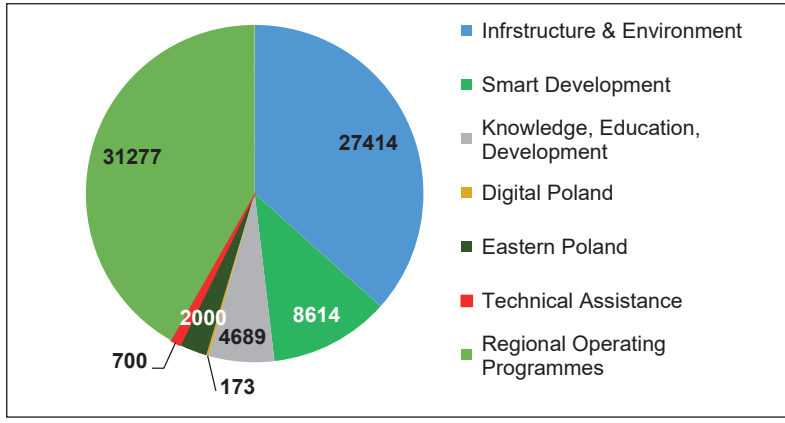

Figure 4.
Division of the Cohesion Funds allocated to Poland in the programming period of 2014–2020 (million EUR)

Source: Rödl & Partner s. a.

The use of EU funds is very transparent. The procedures were carefully prepared to ensure that the funds are used according to the EU regulations. There has been no scandal related to the use of EU funds. Naturally, this strive to ensure correctness in the use of EU funds results in long-lasting application procedures thus making the system costly to both public bodies and support applicants.

The Socioeconomic Effects of Integration

In case of the Polish economy, the transition process was closely linked with the integration process. The first step to put the economy on the development path was the fight of hyperinflation. From the beginning of the 21st century, the inflation in Poland does not show double digits (Table 8).

Table 8.
Yearly consumer price index in the years 1989–2017

Year	Previous year = 100	Year	Previous year = 100
1989	351.1	2004	103.5
1990	685.8	2005	102.1
1991	170.3	2006	101.0
1992	143.0	2007	102.5
1993	135.3	2008	104.2
1994	132.2	2009	103.5
1995	127.8	2010	102.6
1996	119.9	2011	104.3
1997	114.9	2012	103.7
1998	111.8	2013	100.9
1999	107.3	2014	100.0
2000	110.1	2015	99.1
2001	105.5	2016	99.4
2002	101.9	2017	102.0
2003	100.8		

Source: GUS 2018

As soon as the Polish economy overcame the recession accompanying the transition process, it entered the growth path which has been following ever since (Table 9). Even during the financial crisis, the Polish economy continued to grow and in 2009 it was the only EU country with a positive GDP growth.

Table 9.
Polish GDP growth in the years 1991–2016 (%)

Year	GDP growth	Year	GDP growth
1991	–7.0	2004	5.1
1992	2.5	2005	3.5
1993	3.7	2006	6.2
1994	5.3	2007	7.0
1995	7.0	2008	4.2
1996	6.1	2009	2.8
1997	6.5	2010	3.6
1998	4.6	2011	5.0
1999	4.6	2012	1.6
2000	4.6	2013	1.4
2001	1.2	2014	3.3
2002	2.0	2015	3.8
2003	3.6	2016	2.9

Source: WB[11] s. a.

Unemployment was a phenomenon not observed in the socialist economy. Due to transformation reforms, it rapidly appeared in Poland being one of the key social burdens associated with market economy. Yet, the highest unemployment rate was not observed at the beginning of the transformation process but at the beginning of the 21st century which was related to the entering to the labour market of a large group of young people (Table 10).

Table 10.
Unemployment in Poland in the years 1991–2017 (% of total labour force)

Year	Unemployment	Year	Unemployment
1991	11.9	2005	17.7
1992	13.3	2006	13.8
1993	14.0	2007	9.6
1994	14.4	2008	7.1
1995	13.3	2009	8.2
1996	12.4	2010	9.6
1997	11.0	2011	9.6

[11] WB: World Bank.

Year	Unemployment	Year	Unemployment
1998	9.9	2012	10.1
1999	12.3	2013	10.3
2000	16.3	2014	9.0
2001	18.4	2015	7.5
2002	19.9	2016	6.2
2003	19.4	2017	5.1
2004	19.1		

Source: WB s. a.

The EU membership brought Poland a huge outflow of people. These were generally young, mostly well-educated people. This process started immediately after the accession to the EU as the United Kingdom and Ireland did not establish any interim period and free movement and thus, legal work, was possible already in 2004. The highest number of Poles temporarily living abroad was observed in 2007 and it amounted to 2.3 million citizens, (GUS 2012b) i.e. about 6% of Poland's population. Over 80% of these citizens were staying in EU countries. Most of the people left Poland in the first years of the Polish EU membership when the unemployment rate in Poland was very high in comparison with the U.K. or Ireland so this was not a significant problem for the Polish economy. In fact, it resulted in lowering of the unemployment rate and the inflow of money transfers which supported the families in Poland. Personal remittances started to grow before the EU accession (Table 11), but their rapid growth was observed in the first years of the EU membership reaching a peak in 2006. Since 2008, there has been a constant fall in personal remittances expressed as a share of GDP.

Table 11.
Personal remittances, received (% of GDP)

Year	Personal remittances	Year	Personal remittances
1994	0.52	2006	2.46
1995	0.51	2007	2.44
1996	0.48	2008	1.96
1997	0.53	2009	1.86
1998	0.61	2010	1.60
1999	0.49	2011	1.46

Year	Personal remittances	Year	Personal remittances
2000	0.87	2012	1.40
2001	0.82	2013	1.41
2002	0.85	2014	1.36
2003	1.05	2015	1.42
2004	1.85	2016	1.42
2005	2.11		

Source: WB s. a.

The development of the Polish economy accompanied by a much smaller but still present outflow of Poles and demographic changes led to a reduction of unemployment rate. In recent years, the situation on the labour market became a reverse of the one observed in the beginning of the 21st century. There is a shortage of employees in more and more professions. This includes both highly qualified employees and the ones with only basic skills. The problem includes, among others, nurses, shop assistants and construction workers. The inflow of Ukrainians mitigates the problems with finding employees and limits the growth of salaries. Yet, the structural shortages in numerous professions that are going to be observed in the coming years will not be easy to alleviate based only on Ukrainians.

Currently, Poland occupies the 36th place in the Human Development Index (HDI) ranking (Table 12). The value of the HDI was increasing steadily in the period of 1990–2015, showing changes resulting from the Polish transformation reforms and the EU accession.

Table 12.
Human Development Index for Poland in the years 1990–2015

Human Development Index (value)				Average annual HDI growth (%)				Current rank
1990	2000	2010	2015	1990–2000	2000–2010	2010–2015	1990–2015	
0.712	0.784	0.829	0.855	0.97	0.56	0.62	0.74	36

Source: Compiled by the author based on UNDP[12] 2012.

[12] UNDP: United Nations Development Programme.

It must be emphasised that a significant role in the socio-economic development of Poland has been played by the EU funds. There is no sufficiently robust way to evaluate the impact of EU funds on the Polish economy as it is impossible to separate the effects of the EU funds from other factors. Naturally, each of the policy measures as well as programmes has a different focal point and cannot in a similar extent contribute to each of the developmental priorities named. Yet, generally it is also difficult to name the key impact mechanism and effect, as policy instruments contribute to several policy objectives both directly and indirectly. It is estimated that the cohesion policy in the 2007–2013 period increased Polish GDP by 1.7% a year in relation to what it would have been without the cohesion policy investment. Moreover, it increased the employment by 1%. In 2020, it is estimated that the Polish GDP will be over 4% higher than without the cohesion policy between 2007–2013. It must also be mentioned that in the period of 2010–2012, the cohesion policy investment amounted to approximately 55% of the public investment in Poland. (EC[13] 2014)

Conclusion and Outlook: Drawing the Balance of the Results of Integration

Polish integration has been successful. Poland has made a good use of the opportunities given by the EU single market and the EU funds allocated to it. In numerous locations and parts of the economy, the EU support enabled leapfrogging several stages of technology development thus significantly modernising the economy. Polish governments have always tried to form the integration in a way that supports Polish national interests. Naturally, the understanding of what is in the Polish state interest has been changing with political parties coming to power. The same applies to the effectiveness of the efforts when negotiating with the European Commission and other member states.

The primary reason for the success was the willingness of authorities at every level of Polish administration to make full use of the EU funds and the willingness of individual people and companies to grab the opportunity for development and improvement. Naturally, this positive attitude and willingness to act had to be accompanied with the capacity to do so.

[13] EC: European Commission.

This capacity was created by a significant increase in the employment in public administration. A huge number of young people who graduated after 1990 and were keen on introducing effectiveness and efficiency in public administration as well as building well-functioning administrative units were vital for success.

The economic integration with the EU is not complete. Poland is obliged by its accession treaty to become a member of the Eurozone. The debate on this issue has its ebbs and tides. After becoming an EU member, Poland was very keen to quickly get the access to the Eurozone club but its economy was still not transformed enough to fulfil the Maastricht criteria for accepting the euro. Yet, the government's economic policy was aimed at fulfilling these standards. The tight binding of the Polish economy with the EU makes it already strongly dependent on the situation of the Eurozone countries, however, the financial and economic crises showed that Poland as a relatively big country could safeguard economic growth even in 2009 when all the other EU member states experienced a negative change in the GDP. The period of crises showed that the ability to shape one's own economic policy can bring positive results and the lack of full integration can be a barrier for spilling off a crisis. Currently, there is not much debate on the euro. Public opinion on the matter fluctuates depending on the economic situation and exchange rate. Yet, as the study by Goczek and Mycielska (2014) found, the Polish monetary policy shows such a close resemblance to the one conducted by the European Central Bank that the argument of the independence of the monetary policy as a reason for keeping the Polish zloty is not valid. It seems that the political benefits of joining the Eurozone outweigh the economic ones.

The other problem Poland is facing is the need to foster development and avoid the so-called middle income trap. The way to avoid it is to boost innovations. Yet, despite the growing economy, Poland still remains at the end of the most competitive and innovative EU countries. The increase in innovations would enable to base the Polish economy on more stable competitive advantages. Moreover, Poland needs to increase its efforts in transforming its economy from carbon-based to green and circular one. This is not only the issue of contributing to the EU developmental strategy but also an urgent need to ensure sustainable development and to reduce the problem of low quality of air. Currently, numerous Polish cities are ranked high on the list of the EU's most polluted cities with the level of smog particles exceeding the norms by several hundred percent.

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Chapter 6.

Economic Integration and Interdependence in Romania

A Challenging Transition to Market Economy

Cristian Băhnăreanu

Introduction

Until 1989, Romania had been in the sphere of Soviet political, economic and military influence that had an impact on all areas of social life. The economy followed the path of socialist development which meant a process of hard restructuring by the gradual liquidation of private property and competition, the centralised development of the economic branches on the basis of the five-year plans, the predominant orientation of the production to export, especially the countries of the Council for Mutual Economic Assistance (CMEA), the support of the domestic consumption and limitation of imports, etc. All this led to the deepening of structural, technological, managerial and mentality gaps toward the West, which was obvious in the early years of democracy.

Shortly after removing the communist regime, Romania entered the path to integration in the European economic bloc and international economic circuits. This process was extremely difficult because both of the socialist legacy (state-controlled processes and procedures, outdated technology, energy-intensive and unprofitable enterprises, etc.) and the European accession criteria to be met. The accession criteria were related to institutional stability (democracy, human and minority rights), functional market economy, and the ability to meet the obligations stemming from membership (administrative capacities and community acquis). Thus, the period after the 1989 Revolution until the end of 2006 represented for Romania a permanent transition, from

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a centralised economy to a functioning market economy and a democratic system based on the rule of law. The strategic objective was joining the European Union. This objective enjoyed the greatest popular support among the countries of Central and Eastern Europe (CEE). The Romanian public perception was that once you get into the "European club", economic and social problems would quickly find their way. Still, the achievement of the market economy criteria required efforts from both the executive and the population to reform and modernise the entire economy. According to the schedule, Romania signed on 25 April 2005 the Accession Treaty with the European Union and became a full member on 1 January 2007. After joining the European community, Romania has been given new status and roles in all areas of economic, social and political life, but actual integration measures (moving from formal to real integration) have remained topical.

The Conditions at the Beginning of the Integration Process

Prior to 1989, Romania went through at least two phases that marked the structure and organisation of the post-communist economy. In the first phase between 1949 and 1962, the Romanian Communist Party carried out an aggressive collectivisation process, consisting in confiscating most of the private agricultural property and their merging into the so-called Agricultural Production Cooperatives (ACPs). After the end of the 1960s, industrialisation was the second phase, consisting in massive investment in construction of production capacities and the development of main economic branches such as chemistry and petrochemistry, metallurgy, siderurgy, power engineering, machine building, etc. An oversized, export-oriented industry was created, which needed energy resources that could not be fully provided by internal sources because the commissioning of new power generation capacities did not keep the pace. At the same time, there was also the "new agrarian revolution" aimed at modernising and re-technologising the Romanian agriculture. Romania gradually turned from an agrarian-industrial country into an industrial-agrarian one, giving the fact that in 1989 the structure of the Gross Domestic Product (GDP) was 52%—industry and construction, over 14%—agriculture and 34% other industries. (Georgescu 2015) Of course, everything was done on the background of the state planning—a basic instrument of the socialist economic policy. The economic activity was subjected to certain administrative-bureaucratic decisions that blocked

any attempt to develop market on a competitive basis. This type of planning has generated a huge waste of financial, material and human resources and created an inertial mechanism that cancelled any initiative under the pretext of respecting the objective laws of Socialism. (STĂNESCU 1991) During this period, the permanent strengthening of the leading role of the Party throughout the economic and social life was recorded.

Externally, the U.S. developed a special economic relationship with the Socialist Republic of Romania and granted it the Most-Favoured-Nation (MFN) status (1975). In addition, the country has been given access to funding through the International Monetary Fund (IMF). Soon, Romania's position on foreign relations changed radically. Because of disagreements with international creditors, Nicolae Ceaușescu decided to pay in advance all external debt, which reached about USD 11 billion in 1980. The isolation policy deepens even more by giving up in 1988 the benefit of the MFN because Ceaușescu's belief that the U.S. wanted to intervene in the Romanian domestic policy.

As far the main macroeconomic indicators before 1989, we are reserved for the credibility of the figures, knowing that one of the characteristics of the reporting system during the dictatorial regime was the falsification of the data (Table 1). The table shows that Romania had a good economic and financial situation at the beginning of the 1990s, even though the economic performance and living standards of the population were not very high and the unemployment and inflation were not officially recognised. There was a relatively strong economic basis from which the country could go into the process of restructuring and reforming and there was opportunity for the Romanian economy to reintegrate into the regional and world economic and trade circuits. This fact is also demonstrated by the constant values of Human Development Index (HDI) (0.786 in 1980, 0.792 in 1985, 0.777 in 1990), (UNDP[1] 2007) which, regardless of the calculation method, has consistently included Romania in the category of countries with a medium level of development.

[1] UNDP: United Nations Development Programme.

Table 1.
The main indicators of the Romanian economy in 1989

Indicators	1980	1985	1988	1989	1990
GDP (USD billion)	29.38	38.92	40.81	38.00	40.19
GDP per capita (USD)	1,323	1,713	1,770	1,641	1,732
Budget balance (USD billion)	0.06	0.86	2.11	2.86	–0.19
Industrial enterprises	1,752	1,913	2,091	2,102	2,241
Cultivated area (thousand hectares)	9,569.5	9,890.5	9,700.2	9,846.8	9,402.1
Investments (USD billion)	10.02	11.73	11.44	11.26	8.02
Employment in total population (%)	46.62 (10,350,100)	46.58 (10,586,100)	46.87 (10,805,400)	47.28 (10,945,700)	46.71 (10,839,500)
Average net salary (USD/month)	107	135	140	146	161
Unemployment rate (%)	–	–	–	–	2.4
Inflation rate (%)	2.1	0.8	2.2	1.1	5.1
Commercial balance (USD billion)	–	1.56	3.61	2.56	–1.74

Note: The conversion from Romanian leu (RON) to USD was made at the official rate of the 1990s (21 RON to 1 USD). CFSN[2] 1990b

Source: CNS[3] 1991; INS[4] 2017a

The transition process of the Romanian economy had a slow evolution, marked by numerous ups and downs. A weaker legislative and institutional framework, lack of financial resources or reticence of economic agents has often influenced sectoral programs and strategies. Even in the first months of the fall of the communist regime, Romania has targeted the "return to the authentic values of European democracy and civilization", (*Proclamația de la Timișoara* 1990) with integration into the EU and NATO becoming the main objective of foreign policy. The Program of the Declaration of the Romanian Government of June 1990 had as a major direction the transition

[2] CFSN: Consiliul Frontului Salvării Naționale (en – Council of the National Salvation Front).

[3] CNS: Comisia Națională pentru Statistică (en – National Commission for Statistics).

[4] INS: Institutul Național de Statistică (en – National Statistics Institute).

to a democratic society and a market economy based on political, economic and social reforms. (Ionescu 2006) The strategic objective of EU integration appears for the first time in Romania's National Security Strategy, which states the "clear and irrevocable option of integration into the NATO and the EU" (Președintele României 1999, 5) as a useful tool to promote national interests of democracy, prosperity and security. The objective of joining the EU and NATO has coalesced the nation's resources and catalysed reforms in the economy and society. As the political class and civil society promoted this objective, presenting the advantages for the country, the attitude of the population quickly became a strong positive one. The popular support towards EU integration reached the highest rates among the Candidate Countries, from 79% in 1991 dropping to 70–71% in 1995 and 1997. (CEC[5] 1992; EC[6] 1996; 1998) Even before Romania's accession to the EU, this process continues to be supported by 75% of the population in autumn 2004 and 61% in autumn 2005. (EC 2005; 2006) Pro-European support remained high, because the population perceived integration as a repair of a great historical injustice, designed to solve both the security and prosperity issues.

Interdependence and Economic Penetration

The analysis of the most important macroeconomic indicators over the 27 years (1990–2016) highlights at least five periods of the evolution of Romanian economy (Table 2 and Figure 1).

Table 2.

The evolution of growth rate and other important indicators between 1990 and 2016

Year	Growth rate (%)*	GDP per capita (USD)*	Inflation rate (%)**	Unemployment rate (%)***
1989	–5.8	2,330	1.1	–
1990	–5.6	1,652	5.1	2.4
1991	–12.9	1,249	170.2	5.6
1992	–8.7	853	210.4	6.6
1993	1.5	1,155	256.1	7.4

[5] CEC: Commission of the European Communities.

[6] EC: European Commission.

Year	Growth rate (%)*	GDP per capita (USD)*	Inflation rate (%)**	Unemployment rate (%)***
1994	3.9	1,325	136.7	8.2
1995	7.1	1,573	32.3	8.0
1996	3.9	1,575	38.8	6.7
1997	–6.1	1,582	154.8	5.5
1998	–4.8	1,897	59.1	5.6
1999	–1.2	1,611	45.8	6.2
2000	2.9	1,670	45.7	7.0
2001	5.6	1,817	34.5	6.6
2002	5.2	2,119	22.5	8.1
2003	5.5	2,768	15.3	7.0
2004	8.4	3,542	11.9	7.7
2005	4.2	4,663	9.0	7.2
2006	8.1	5,811	6.6	7.3
2007	6.9	8,125	4.8	6.4
2008	8.5	10,160	7.9	5.8
2009	–7.1	8,221	5.6	6.9
2010	–0.8	8,277	6.1	7.0
2011	1.1	9,214	5.8	7.2
2012	0.6	8,542	3.3	6.8
2013	3.5	9,568	4.0	7.1
2014	3.1	10,001	1.1	6.8
2015	3.9	8,934	–0.6	6.8
2016	4.8	9,493	–1.5	5.9

Source: *: IMF[7] 2017; **: INS 2017a; ***: WB[8] 2017b

In the first three years, GDP fell sharply to almost a third of the one of 1989, with the highest negative growth rate in 1991 (–12.9%). The existing effects of Romania's isolation policy and the short-term policies implemented by the first governments have degraded the national economy. Most of the sectors declined: industry from 40.5% in 1990 to 37.9% in 1991, construction from 5.4% to 4.3% and agriculture from 21.8% to 18.8%. (NIS s. a.) Thus, production has declined considerably, inflation and budget deficit have risen rapidly,

[7] IMF: International Monetary Fund.
[8] WB: World Bank.

investments and exports have fallen slowly and imports have experienced an exponential growth because of the high demand for products that have been lacking for years on the market (food, electronics, home appliances, etc.). Between 1993 and 1999, Romania's economy has fluctuated, with the GDP rising by almost USD 10 billion. In the first years, there were taken a series of measures aimed at stopping the decline and stabilising the national economy and creating the legislative and institutional framework for the transition to the market economy.

The highest rate of economic growth was recorded in 1995, when the Agreement for Romania's Association to the European Union entered into force and Romania applied for EU membership (MAE[9] s. a.) It is noteworthy that in the middle of the 1995–1997 period, Romania's GDP stagnated around USD 36 billion. The implementation of the so-called "shock therapy" program—accelerating structural reforms with an emphasis on price liberalisation in areas that were still under state control (energy, agricultural products, public services); liberalisation of the exchange rate regime; reductions in import duties; eliminating subsidies, especially subsidised loans for agriculture; attracting foreign investment; institutional reforms—and the adoption, with the support of the IMF and with support of the "anti-crisis program"—the acceleration of the privatisation of state companies, including banks, and the completion and updating of the legislative and institutional framework in line with the Romanian society development (AR[10]–SRS[11]–FNSA[12] 2004) were not reflected in economic growth. There was a sudden interruption of the positive evolution of the economy in the period of 1997–1999, when growth rate recorded –6.1% in 1997, –4,8% in 1998, and –1.2% in 1999. However, at the Helsinki European Council (December 1999) it was decided to open accession negotiations with Romania.

[9] MAE: Ministerul Afacerilor Externe (en – Ministry of Foreign Affairs).

[10] AR: Academia Română (en – Romanian Academy).

[11] SRS: Societatea Română de Statistică (en – Romanian Society of Statistics).

[12] FNSA: Fundația Națională pentru Știință și Artă (en– National Foundation for Science and Art).

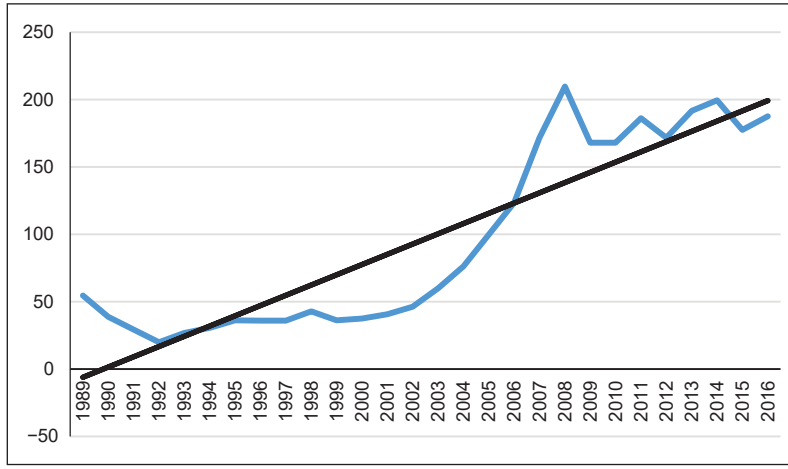


Figure 1.
The evolution of GDP between 1990 and 2016

Source: IMF 2017

Since 2000, the Government has made considerable efforts to achieve the conditions for macroeconomic stabilisation and recovering economic growth. Statistical data from 2000 to 2008 show visible progress of the national economy by implemented reforms—GDP has steadily increased from about USD 37.5 billion in 2000 to over USD 209 billion in 2008, industry and services being the main growth engines. In addition, the accelerated growth was boosted by the boom in the real estate sector and it was based on the disinflation process, the tighter control of the budget deficit and the reduction in the unemployment rate. However, domestic demand—driven by rapid credit expansion, wage increases and, to some extent, increasing arrears—has replaced exports as the main driver of growth. In this period, Romania recorded the highest growth rate in Central and Eastern Europe (5.7% in 2001, 5% in 2002, and 8.1% in 2006) and even the largest in the EU (8.5% in 2008), (Eurostat s. a.a) which was also reflected in the continuous increase of GDP per capita from only USD 1,670 in 2000 to over USD 10,000 in 2008. These positive results were also confirmed by the recognition of Romania's status as a functioning market economy, (CEC 2004) the signing of the Accession Treaty of Romania to the EU (2005) and the formal acceptance of Romania as a full Member State of the EU (2007).

The outbreak of the economic and financial crisis has not dramatically affected Romania, due to the lower degree of financial integration of the transition economies with developed economies. However, the end of 2008 was marked by the slowdown in the economic growth, the deepening of the current account deficit, the lack of foreign investment and increasing unemployment. Romania entered recession in 2009, when GDP fell for two consecutive quarters. After a record 8.5% growth in 2008, the national economy contracted sharply in the next two years (–7.08% in 2009 and –1.27% in 2010), with GDP declining by over USD 40 billion. Most economic indicators recorded depreciation, including the share of GDP in the main branches. The growth-driven sectors in 2000–2008 were the ones that pulled the economy down the most: construction and services continued to decline from –13.6% and –6.8% in 2009 to –10.7% and –2.8% in 2010. (INS 2010; 2011) A positive aspect was the significant decrease in imports (–11.1%) due to a decrease of final consumption and a slight increase in exports (2.9%). The increase in prices, excise duties, and VAT or the rigidities at sectoral level led Romania to the second consecutive year at the forefront of high-inflation EU countries. (Eurostat s. a.b) The annual inflation rate was 5.6% in 2009 and 6.1% in 2010, levels that exceeded the upper margin of the 4.5% target set by the National Bank of Romania (NBR). While real demand has suffered drastic contraction, consumer prices have risen in 2010 when service tariffs have experienced the highest growth. In fact, the over 100,000 personnel laid off in the public sector have led to an increase in unemployment rate to 6.3% in 2009 and 6.87% in 2010, compared to about 4% in the pre-crisis period. (ANOFM[13] 2010; 2011) This situation was also influenced by the reduction of public sector wages, the drastic limitation of new public-sector employment and the capping of personnel costs. Austerity measures have led to relative economic stabilisation but have amplified social grievances reflected in a sharp decline in income, consumption and, in general, the standard of living of the population. After a period when Romania was among the few countries that failed to overcome the crisis, the economic growth recovered in 2011 (1.1%). Increased investment, rise in internal and external demand and industrial orders have given new impetus to the national economy.

[13] ANOFM: Agenția Națională pentru Ocuparea Forței de Muncă (en – National Agency for Employment).

If we relate to the 10-year period since joining the EU, Romania's GDP grew from USD 123 billion in 2006 to USD 187 billion in 2016. This means an increase of over 52% despite the fact that it dealt nearly five years with economic difficulties generated by an economic and financial crisis and sovereign debt crisis. However, the nominal value of GDP has not yet reached record level (USD 210 billion) in the pre-crisis period, but it was close to the USD 200 billion threshold in 2014. With an average annual growth rate of 2.5% in the national economy, the share of GDP in the main branches varied in those ten years as follows: agriculture halved from 7.8% in 2006 to 3.9% in 2016, industry and construction declined slightly from 24.5% to 23.1% respectively from 7.4% to 6%, and services grew from 49% to 56.5%. (Anghelache–Dumitrescu 2013; INS 2017b) GDP per capita fluctuated in this period around USD 8,000–10,000, but Romania continued to record high levels of the income inequality indicator. In addition, the inflation rate has fallen sharply and the unemployment rate has been maintained with small variations of 6–7%.

The sustainability of public finance was a permanent challenge to public policy taking into account that sovereign debt grew at a higher pace than economic growth. Romania's public debt has always shown a growth trend in these 27 years, rising from USD 210 million in 1990 to nearly USD 70 billion in 2016. The debt quickly reached a threshold of about USD 5 billion in 1995, USD 10 billion in 2001, USD 25 billion in 2006, USD 50 billion in 2010, and USD 75 billion in 2013. (Analize economice 2016) As a share of GDP, debt increased strongly in the first four years, from 0.8% in 1990 to 22% in 1993. The largest share of government debt in GDP was reached in 1999 (32.7%), followed by a steady decline until EU accession (18.3% in 2006). (Curtea de Conturi a României 2015) In the 10 years of EU membership (2007–2016), the debt-to-GDP ratio increased by 2.25 times, from 19.7% to almost 44.5%.

At the beginning of the transition period, Romania's external trade was still influenced by the 1980s policy of expanding exports and minimising imports in order to pay external debt. There was action to implement modern rules of the market economy in commercial activity by eliminating the state monopoly on external trade and increasing the share of the private sector, changing the currency regime and introducing convertibility, implementing a new customs tariff. As can be seen in Table 3, 1989 was the last year in which Romania's trade balance was in surplus. In the following two decades and a half, imports steadily exceeded exports. In the first four years

(1990–1993), the trade deficit was sustained by the loss of traditional markets of former USSR and CAER,[14] the Gulf crisis and the transition since 1991 of all import–export operations in international prices. (AR–SRS–FNSA 2004) A positive element during this period was the approval (October 1990) by the Commission of the European Economic Community of the generalised system of trade preferences with Romania. (Ionescu 2006)

Since 1994, exports have been given a new impetus as a result of support measures for competitive producers and facilities for companies with foreign capital. Against this backdrop, exports almost doubled to USD 8.4 billion in 1997 versus USD 4.3 billion in 1991. After keeping growth within reasonable limits in 1991–1994, in 1995 imports had a boom of over 44% over the previous year, surpassing for the first time the USD 10 billion threshold. Subsequently, the increase in imports was limited, being generally oriented towards investment in equipment, machinery and technology, but also to some consumer goods. The reduction of consumption and capital investment amid the deterioration of the economic situation led to a steady decline in Romania's foreign trade over the period of 1997–1999. The value of exports and imports recorded a significant advance of nearly USD 2 billion and USD 2.5 billion in 2000. Then, the growth rate of foreign trade accelerated progressively over the next six years (2001–2006).

Table 3.

Export/import and trade balance between 1990 and 2016

Year	FOB Exports (USD billion)	CIF Imports (USD billion)	FOB/CIF Balance (USD billion)	FOB to CIF ratio (%)
1989	10.487	8.438*	2.049	124.3
1990	5.775	9.202*	–3.427	62.8
1991	4.266	5.793	–1.527	73.6
1992	4.363	6.260	–1.897	69.7
1993	4.892	6.522	–1.630	75.0
1994	6.151	7.109	-0.958	86.5

[14] CAER: Consiliul de Ajutor Economic Reciproc (en – Council for Mutual Economic Assistance).

Year	FOB Exports (USD billion)	CIF Imports (USD billion)	FOB/CIF Balance (USD billion)	FOB to CIF ratio (%)
1995	7.910	10.278	–2.368	77.0
1996	8.084	11.435	–3.351	70.7
1997	8.431	11.280	–2.849	74.7
1998	8.302	11.838	–3.536	70.1
1999	8.487	10.557	–2.070	80.4
2000	10.367	13.055	-2.688	79.4
2001	11.385	15.552	–4.167	73.2
2002	13.876	17.862	–3.986	77.7
2003	17.618	24.003	–6.385	73.4
2004	23.485	32.664	–9.179	71.9
2005	27.730	40.463	–12.733	68.5
2006	32.336	51.106	–18.770	63.3
2007	40.471	70.414	–29.943	57.5
2008	49.674	84.286	–34.612	58.9
2009	40.579	54.344	–13.765	74.7
2010	49.494	62.098	–12.604	79.7
2011	63.042	76.540	–13.498	82.4
2012	57.921	70.285	–12.364	82.4
2013	65.879	73.519	–7.640	89.6
2014	69.886	77.907	–8.021	89.7
2015	60.618	69.861	–9.243	86.8
2016	63.589	74.627	–11.038	85.2

*FOB prices

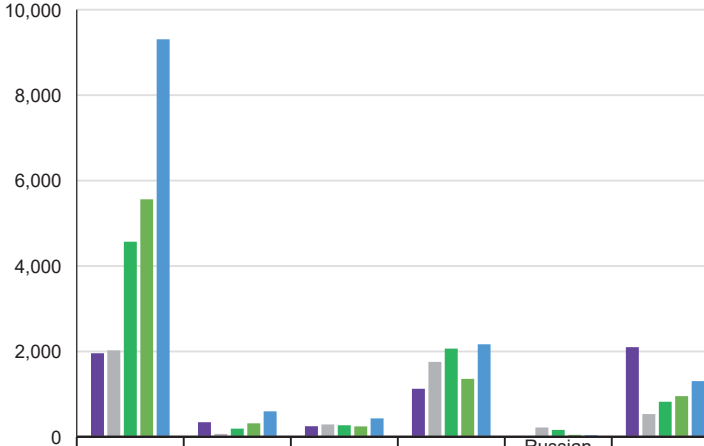
Source: NIS 1995; 1997; 2003; 2007; 2012; 2017

The implementation of a monetary and fiscal stimulus policy has led to the development of trade agreements both bilaterally and with EU countries. During this time, Romania's trade relations were relaunched by the implementation of the regulations provided for in the regional agreements to which the country became a party. In particular, there are the Association Agreement with the EU and the countries of the European Free Trade

Association (EFTA), the Central European Free Trade Agreement (CEFTA), the completion of the trade treaty with the U.S. and granted again with the MFN status, the establishment of a generalised system of custom preferences in relations with other OECD partners, the creation of free trade areas with Central and Eastern European (CEE) transition countries.

After Romania joined the EU, the external trade experienced an extraordinary momentum with annual growth rates of USD 8–9 billion for export and USD 14–18 billion for import in the first two years (2007–2008). This expansion was interrupted by the economic problems raised by the economic and financial crisis (19% decrease in export and 36% in import in 2009 compared to the previous year), sovereign debt crisis (8% decrease in export and import in 2012 compared to of the previous year) and political instability (13% decrease in export and 10% in import in 2015 compared to the previous year). Trade deficit shrank by a maximum of USD –34.6 billion in 2008 to a minimum of USD –7.6 billion in 2013 and USD –11 billion in 2016, as the export to import ratio increased to 80–90% from 2010.

During the analysed period, Romania's trade relations experienced a stronger dynamic in terms of geographical distribution, increasing the share in total export and import to/from developed countries, especially EU Member States, and a slight reduction to/from developing and transition countries (Figure 2 and 3). If in the first three years of transition (1990–1992) export to developed countries had relatively declined, in the next 10 years they entered an ascending trend, exceeding USD 10 billion in 2002. Thus, export to developed countries was four times higher in 2002 than in 1990, their share in total rising from 44% to 74.5%. Romania's import has registered a similar evolution, with noting that it also increased in the first years after the 1989 Revolution. Thus, import from developed countries increased 4 times in the period of 1990–2002, with an annual average of USD 728 million.



	EU	US	Others	Developing countries	Russian Federation	Others
1990	1956	342	250	1126		2101
1993	2023	69	291	1754	220	535
1996	4569	192	270	2066	164	823
1999	5562	317	245	1358	47	952
2002	9310	599	433	2166	40	1304

Figure 2.
Romania's FOB exports by countries and categories of countries, 1990–2002 (USD billion)

Source: NIS 1995; 1997; 2003

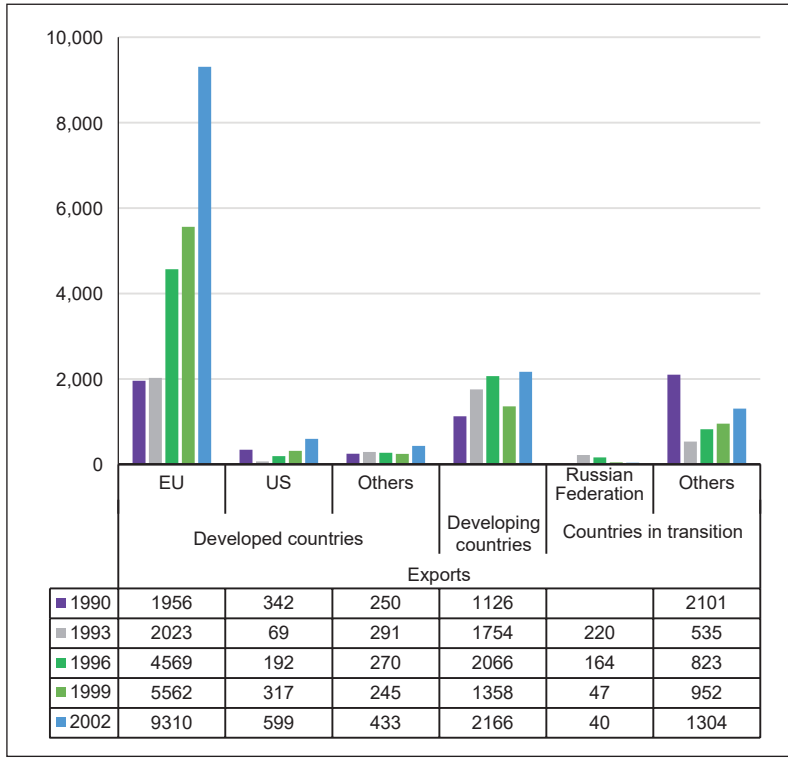


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Figure 3.
Romania's CIF imports by countries and categories of countries, 1990–2002 (USD billion)

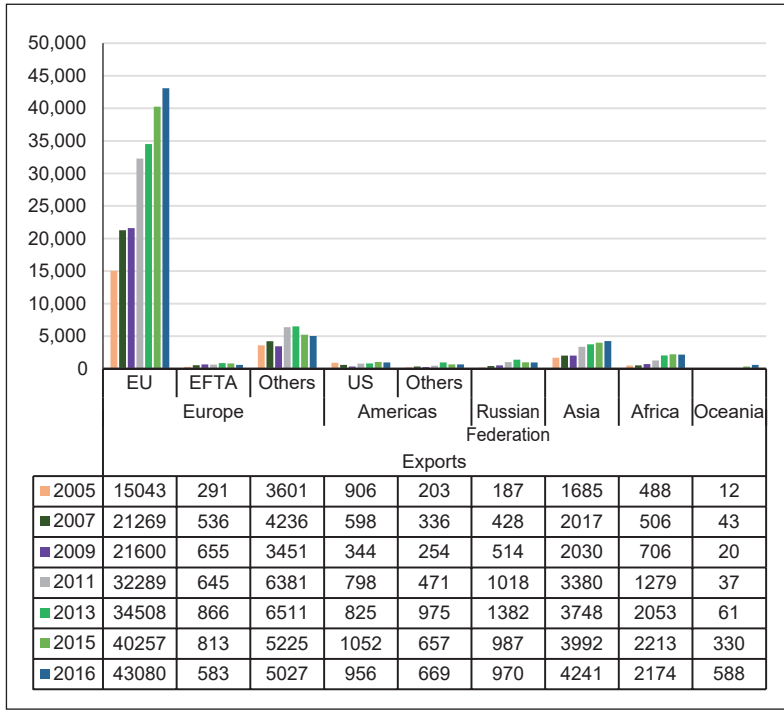
Source: NIS 1995; 1997; 2003

Just before joining the EU, the Union became Romania's main trade partner, with exports and imports to/from this destination/source increasing almost 5 times in 2002 as compared to 1990. Trade with the U.S. and the Russian Federation experienced a very poor evolution in the period of 1990–2002, their cumulated share reached in 2002 only 4.6% of Romania's total export and 10.2% of the total import. In the top export destinations in 2002, seven of the nine partners on the European continent were EU countries. Same, in

the ranking of the top sources of import, six of the eight partners in Europe belonged to the EU. (INS 2016) If in 1990, the most important trade relations were made with the USSR, Germany, Saudi Arabia, the U.S., Iran, Italy, Poland or Bulgaria, (Comisia Națională pentru Statistică 1991) in the following years, there was a clear orientation of Romania's foreign trade to the EU market. In 2002, the main trading partners in the EU were Italy with exports of USD 3.46 billion (25% of Romania's total exports) and imports of USD 3.69 billion (20.7% of total imports of Romania), Germany with exports USD 2.17 billion (15.6%) and imports of USD 2.66 billion (14.9%) and France with exports of USD 1 billion (13.8%) and imports of USD 1.14 billion (6.4%). The top three export destinations were followed by the U.K. with USD 0.8 billion, the U.S. and Turkey with about USD 0.6 billion each, and import sources—the U.K. with USD 0.7 billion, Hungary and Austria with USD 0.6 billion each. (NIS 2003)

In the transition years there have been major changes in the structure of exports by group of goods, due to the reconfiguration of markets, the increasing competition, the lack of competitiveness and the restructuring of production capacities. If in 1990, in most groups of goods, except for "mineral products", the value of exports fell below USD 1 billion, in 2002 the number of those exceeding this sum rose to five: "mineral products", "textiles, clothing, leather, footwear", "metal products", "machinery and mechanical appliances, electrical equipment", and "other products" (wood products, including furniture, construction supplies, etc.). The most significant increase was recorded by the "textiles, clothing, leather, footwear" with 6.6 times in 2002 compared to 1990 (their share in total tripled during this period), followed by the "agri-food products"—5.3 times, "other products"—2.4 times, "machinery and mechanical appliances, electric equipment"—2.3 times and "chemical products, plastics, rubber"—2.1 times. (AR–SRS–FNSA 2004) In general, imports targeted both consumer goods as well as raw materials, equipment and technologies for productive activity. If in 1990 only three groups of goods—"agri-food products", "mineral products" and "machinery and mechanical appliances, electric equipment"—registered a value of imports of over USD 1 billion, in 2002 all of the groups exceeded this level. The most significant increase was recorded by the "textiles, clothing, leather, footwear" with 10.3 times in 2002 compared to 1990 (their share in total being five times higher during this period), followed by "chemical products, plastics, rubber" and "other products"—3.3 times, "metal products"—2.5 times, "machinery and mechanical appliances,

electric equipment"—2.3 times. (Academia Română 2004) Since 2005, when Romania signed the Accession Treaty with the EU, external trade has boosted, especially with the EU Member States (Figure 4 and 5). In 2005–2016, exports and imports to/from the European countries increased 2.6 times and 2.3 times, but trade with the U.S. remained relatively constant: EUR 0.9–1 billion value of exports and EUR 0.6 billion value of imports. Over the same period, exports to other destinations increased: Asia–EUR 2.6 billion, Africa–EUR 1.7 billion, Russia–EUR 0.8 billion. Also, cumulated imports from Asia and Africa increased by EUR 2.5 billion, while those from the Russian Federation fluctuated from a maximum of EUR 3.2 billion in 2007 to EUR 2 billion in 2015 and 2016. (NIS 2006; 2011; 2017)

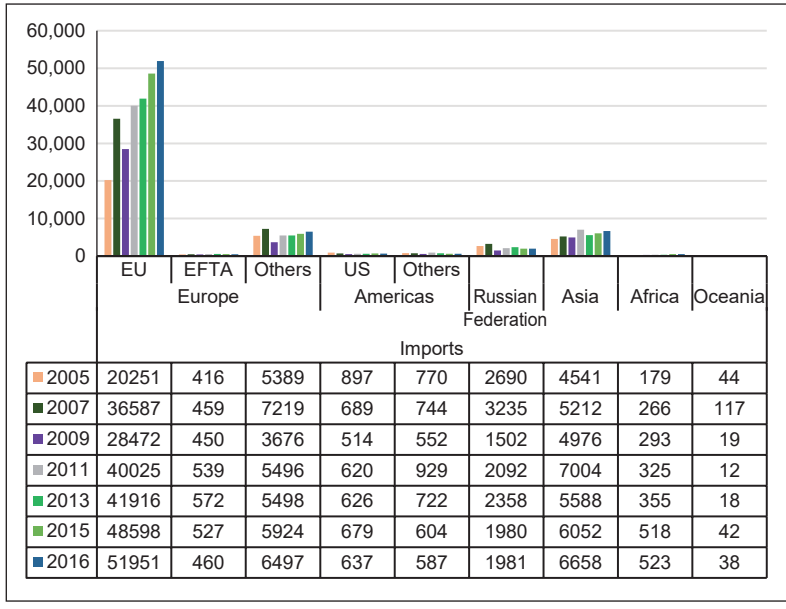


	EU	EFTA	Others	US	Others	Russian Federation	Asia	Africa	Oceania
2005	15043	291	3601	906	203	187	1685	488	12
2007	21269	536	4236	598	336	428	2017	506	43
2009	21600	655	3451	344	254	514	2030	706	20
2011	32289	645	6381	798	471	1018	3380	1279	37
2013	34508	866	6511	825	975	1382	3748	2053	61
2015	40257	813	5225	1052	657	987	3992	2213	330
2016	43080	583	5027	956	669	970	4241	2174	588

Figure 4.

Romania's FOB exports by countries and categories of countries, 2005–2016 (EUR billion)

Source: NIS 2006; 2011; 2017



	EU	EFTA	Others	US	Others	Russian Federation	Asia	Africa	Oceania
	Europe			Americas					
	Imports								
2005	20251	416	5389	897	770	2690	4541	179	44
2007	36587	459	7219	689	744	3235	5212	266	117
2009	28472	450	3676	514	552	1502	4976	293	19
2011	40025	539	5496	620	929	2092	7004	325	12
2013	41916	572	5498	626	722	2358	5588	355	18
2015	48598	527	5924	679	604	1980	6052	518	42
2016	51951	460	6497	637	587	1981	6658	523	38

Figure 5.
Romania's CIF imports by countries and categories of countries, 2005–2016 (EUR billion)

Source: NIS 2006; 2011; 2017

Between 2005 and 2016, Romania's intra-EU trade increased strongly—almost 3 times in case of export and 2.5 times in case of import. Although their share increased from 67.6% in total export and 62.2% in total import in 2005 to 75.1% and 77.1% in 2016, the trade deficit with the EU stabilised to EUR –7–8 billion from a maximum of EUR –15.3 billion in 2007. In this period, Romania's top trading partners did not change radically, the first places being occupied by the strong economies of the EU: Italy increased from export of EUR 4.3 billion and import of EUR 5 billion in 2005 to EUR 6.7 billion export and EUR 6.9 billion import in 2016, Germany—from export of EUR 3.1 billion and import of EUR 4.5 billion in 2005 to EUR 12.3 billion export and EUR 13.8 billion import, France—from export of EUR 1.6 billion and import of EUR 2.2 billion in 2005 to EUR 4.1 billion export and EUR 3.7 billion import in 2016. The top three export destinations were followed by Hungary, the U.K. and Bulgaria, and import sources—the

U.K., Hungary and Austria, with the mention that trade with Hungary exceeded EUR 8 billion in 2016 (surpassing France). Major changes occurred in the structure of export by group of goods in 2016 compared to 2005, as follows: the share in total export of the "machinery and transport equipment" increased from 25.4% in 2005 to 46.9% in 2016 and "other goods" from 7.7% to 13.1%; the total contribution of "manufactured goods classified mainly by the raw material" decreased from 20.9% in 2005 to 16.1% in 2016, "miscellaneous manufactured articles"—from 29.6% to 15.9%, "chemicals and related products"—from 5.7% to 4.4%, "mineral fuels, lubricants and related materials"—from 10.7% to 3.6%. Import also experienced some changes, as follows: the share of total import of the "machinery and transport equipment" increased from 33.2% in 2005 to 38% in 2016, "chemicals and related products"—from 10.2% to 13.4%, "miscellaneous manufactured articles"—from 9.5% to 10.6% and "other goods" from 8.7% to 12.1%; the total contribution of "manufactured goods classified mainly by the raw material" decreased from 24.4% in 2005 to 20.2% in 2016 and "mineral fuels, lubricants and related materials"—from 14% to 5.7%. (NIS 2006; 2017)

As regards the euro area, Romania is among the EU Member States required to adopt the Euro, once all the nominal (the sustainable stability of the public finance, prices, exchange rates and long-term interest rates), legal and real (GDP per capita, labour productivity and other indicators should be near the euro area average) convergence criteria have been fulfilled. (BNR[15] s. a.) According to the latest Convergence Report of the European Central Bank, Romania fulfilled all the nominal convergence criteria and only a part of the legal convergence criteria. (ECB[16] 2016) Given the fact that about 2/3 of Romania's external trade is oriented towards the European market, especially the EU one, the adoption of the euro will bring real benefits. The new currency will stimulate the import and export activities of Romanian companies, as well as the investments, as it will be a stability factor that will reduce the losses of local trading agents caused by exchange rate differences (for example, the fluctuation of the USD against the currencies of the EU countries). As the monetary barriers within the EU will be eliminated, Romanian exporters will access the market of any member country easier. Thus, companies' revenue and profitability will increase as a result of direct exports without intermediaries. Another major advantage of switching to

[15] BNR: Banca Națională a României (en – National Bank of Romania).
[16] ECB: European Central Bank.

the single currency is transparency because the transition of all prices in euro will help Romanian companies to choose the suppliers with lowest costs and export to the countries where they can get the most revenue.

The concern about attracting Foreign Direct Investment (FDI) as a source of financial resources, know-how and new technologies has emerged since the very first months of democracy in Romania. As the economic reform deepened (restructuring and privatisation of the most important state-owned enterprises) and the legislative and institutional framework was created, the attraction of FDI was constantly positive, especially after Romania's accession to the EU. In 1990, Decree-Law no. 96 was adopted on some measures to attract foreign capital investment in Romania, (CPUN[17] 1990) which provided certain facilities for commercial companies with foreign participation, such as: exemption from corporate tax for a period of two years from the achievement of taxable income; 50% reduction of corporate tax for the next three years with the approval of the Ministry of Finance; exemption from customs duties for the in-kind contribution of the foreign party to the share capital. Law No. 35 of 1991 on the foreign investment regime (PR 1991) clarified the regulatory framework by stipulating that foreign investments could not be nationalised, expropriated, requisitioned or subject to other similar measures with the exception of cases of public interest and with the granting of a proportionate compensation investment. As incentives, the Law provided that the foreign investor has the right to fully transfer abroad the annual profits, after paying the taxes, duties and other obligations; the exemption from customs duties of certain import goods required for the investment over a period of two years; exemption from corporate tax for certain periods according to the sector where the investment was made and other conditions. For the granting of certain facilities, for the first time some limits are imposed on the contribution of the foreign investor actually paid out, namely 20% of the share capital of the company, but not less than USD 10,000.

In 1997, the Government Emergency Ordinance (GEO) No. 31 on the foreign investment regime in Romania (GR[18] 1997a) stated that foreign investments benefited from the protection and guarantee provided by the Romanian Constitution and the bilateral and multilateral investment agreements where Romania was part, while maintaining that foreign investments

[17] CPUN: Consiliul Provizoriu de Uniune Națională (en – Provisional National Unity Council).
[18] GR: Guvernul României (en – Government of Romania).

could not be expropriated, requisitioned or subject to other similar measures. The limit for a corporate tax of only 15% for the first two years and certain customs duties exemptions increased to USD 350,000 or its equivalent. The foreign investor that contributed with cash paid of at least USD 5 million in share capital benefited from additional facilities.

In the same year GEO No. 92 was adopted on the stimulation of direct investment (GR 1997b) which provided some tax incentives, such as: exemption from customs duties and, eventually, VAT for the import of personal assets and technological equipment; the possibility of using the accelerated depreciation regime; deduction from taxable profit of advertising costs; recovering the tax loss from taxable profit over a period of 5 consecutive years. During 1991–2001, the level of FDI attracted in the Romanian economy was not very high (just over USD 8 billion), due to the frequent legislative changes, the low attractiveness of the economic environment and the poor condition of the infrastructure (Table 4).

Table 4.

Registrations of commercial companies with foreign participation in subscribed social capital between 1991 and 2001

Year	Registrations of commercial companies with foreign participation		Subscribed social capital	
	Number	% of total	USD billion	% of total
1991	5,499	6.6	1.058	13.0
1992	11,765	14.2	0.573	7.1
1993	10,584	12.7	0.418	5.1
1994	11,051	13.3	0.882	10.8
1995	3,400	4.1	0.238	2.9
1996	3,630	4.4	0.574	7.1
1997	5,249	6.3	0.310	3.8
1998	8,801	10.6	0.756	9.3
1999	7,385	8.9	0.946	11.6
2000	8,569	10.3	0.840	10.3
2001	7,176	8.6	1.541	19.0
Total	**83,109**	**100.0**	**8.136**	**100.0**

Source: Anghelache 2005, 382.

As a source of investment, about 71% came from Europe (58% from the EU), 10% from Asia, 8.8% from North America and the rest from other regions of the world (Figure 6), which brought the Romanian economy closer to the European one. (CCIRMB[19] 2001) We notice the major investment contributions from Cyprus and the Netherlands Antilles (known as *tax haven*), while investments are low from Turkey (3.3%), Greece (3.0%) and Spain (1.8%), and very low from China (0.6%) and Israel (0.4%).

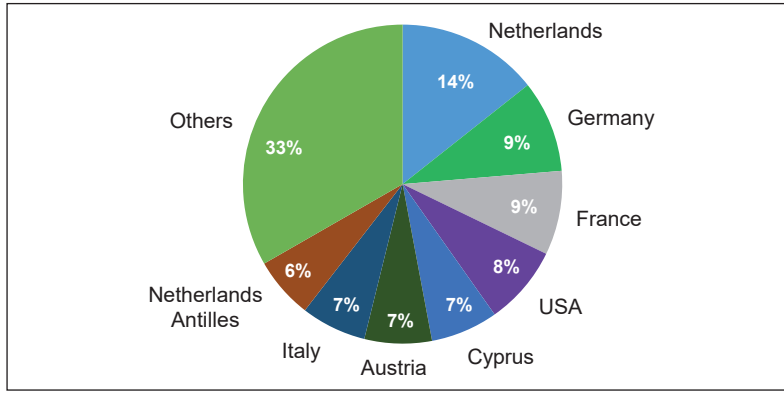


Figure 6.
The top of the investment resident countries in companies with foreign participation in subscribed social capital between 1991 and 2001
Source: CCIRMB 2001, 13.

Regarding the activity structure of the foreign companies with foreign participation registered during 1991–2001, we notice their concentration in the wholesale trade (39.3%), retail trade (19.4%), industry (19%) and professional services (8.7%). During this period, agriculture, tourism, transport and construction are less attractive areas for investors, with shares below 5%. (CCIRMB 2001) Among the most important investment projects, including privatisations, are: Romanian Development Bank (about USD 200 million), Banc Post (USD 92.8 million), Agricole Bank (USD 52 million), RomTelecom (USD 675 million), Automobile Dacia Pitești (USD 269.7 million), Petromidia-Năvodari Petrochemicals Complex (USD 615 million), Rafo Onești

[19] CCIRMB: Camera de Comerț și Industrie a României și a Municipiului București (en – Chamber of Commerce and Industry of Romania and Bucharest.)

Refinery (USD 93.3 million), Sidex Galaţi (USD 500 million), Otelinox Târgovişte (USD 100 million), Phoenix Non-Ferrous Metal Processing Plant in Baia Mare (USD 37 million), Romcim SA Bucharest (USD 400 million), Arctic Găeşti (USD 25 million), etc. (Ghinea et al. 2005) Thus, the share of the private sector in GDP rises rapidly from 12.8% in 1989 and 16.4% in 1990 to 54.9% in 1996, mainly as a result of the transfer of ownership. In the pre-accession period to the EU, the private sector in the Romanian economy reached 71.6% in 2006, up by about 6% over 2000. (NIS 2007) Law No. 332 of 2001 on the promotion of direct investment with significant impact on the economy (PR[20] 2001) positively influenced the investment process, with FDI almost doubled over one year—from USD 840 million in 2000 to USD 1,540 million in 2001. The regulation mainly refers to new investments exceeding USD 1 million or its equivalent, which contributed to the development and modernisation of Romania's economic infrastructure. The facilities granted are referring to exemption from customs duties for imported machinery, plant, equipment, appliances and software products, necessary for the realisation of the investment; postponement of VAT payment for new goods until the investment is becoming operational; the use of accelerated depreciation regime; deduction of 20% of new investments value in the tax return; recovering the tax loss from taxable profit within 5 years. The guarantees granted remained only the prohibition of expropriation, the investor having the possibility to transfer its profits abroad after paying the taxes, duties and other obligations owed to the Romanian legislation.

In 2001, as a result of the facilities introduced by Law No. 332, the investment exceeded for the first time the USD 1 billion threshold. Then, on the basis of relaunching the privatisation program, the foreign capital contribution remained at over USD 3 billion annually between 2004 and 2007, reaching a peak of nearly USD 6 billion in 2008. In the years 2004–2005, the most important companies in the oil and natural gas distribution and power industries were privatised by selling the state-owned majority shareholding, as follows: The Petrom National Oil Company—taken over by the Austrian OMV group for around EUR 669 million; Distrigaz South—acquired by Gaz de France with EUR 128 million; Distrigaz North—taken over by the German company Ruhrgas for EUR 125 million; Electrica Dobrogea and Electrica Banat—bought by the Italian ENEL company for EUR 112 million; Electrica Moldova—taken over by the German group E.ON

[20] PR: Parlamentul României (en – The Parliament of Romania).

Energie with EUR 100 million; Electrica Oltenia—acquired by the Czech group CEZ for EUR 151 million. (Ghinea et al. 2005) Between 1991 and 2006, Europe remained first in the investment rankings with 66.2% of all commercial societies and over USD 16 billion of subscribed social capital, followed by Asia (26.4% and about USD 1 billion) and far away by the U.S. (3.7% and USD 0.87 billion). (ONRC[21] 2007) Romania joining the EU (1 January 2007) had positive effects on investment. There must be noted the establishment of over 15,700 companies in the first year as EU Member State and cumulated FDI of nearly USD 40 billion in 2007–2016. Then the economic and financial crisis that affected the national economy and the effects of the new investment regulations in 2008 halved the number of companies in the following period from 12,264 in 2008 to 6,801 in 2009 and at a minimum of 5,348 in 2016 (Table 5).

Table 5.

Registrations of commercial companies with foreign participation in subscribed social capital between 2002 and 2016

Year	Registrations of commercial companies with foreign participation		Subscribed social capital	
	Number	% of total	USD billion	% of total
2002	7,518	5.9	1.079	2.1
2003	6,609	5.2	1.289	2.5
2004	10,167	8.0	3.032	6.0
2005	11,719	9.3	3.150	6.2
2006	12,823	10.1	3.127	6.1
2007	15,720	12.5	3.314	6.5
2008	12,264	9.7	5.925	11.6
2009	6,801	5.4	4.817	9.5
2010	6,302	5.0	5.145	10.1
2011	6,377	5.0	4.660	9.1
2012	6,385	5.0	3.679	7.2
2013	6,624	5.2	3.150	6.2
2014	6,219	4.9	5.012	9.8
2015	5,831	4.6	1.429	2.8
2016	5,348	4.2	2.169	4.3
Total	**126,707**	**100.0**	**50.977**	**100.0**

Source: Anghelache 2017, 492.

[21] ONRC: Oficiul Național al Registrului Comerțului (en – National Trade Register Office).

After almost seven years, the regulatory framework was updated by the adoption of GEO No. 85 of 2008 on the stimulation of investments. (GR 2008) According to its provisions, facilities are granted to the investments that contribute to one of the following objectives: regional development and cohesion; protection and rehabilitation of the environment; increasing energy efficiency and/or producing and using energy from renewable resources; stimulate R&D and innovation; employment and training. Promoting and attracting FDI in the national economy sectors and activities is provided by the Romanian Investment Agency (subsequently the Department for Infrastructure Projects and Foreign Investment), (PR 2002), which also fulfils the role of intermediary between investors and central and local authorities. Among the advantages granted to economic agents investing in less-favoured areas, where GDP per capita is below the national average and the unemployment rate is high, are: non-refundable amounts for the acquisition of tangible and intangible assets; financial contributions from public budget for newly created jobs; interest-rate cuts when contracting credits.

According to the NBR, the FDI net inflow in 2016 was EUR 4.5 billion, mainly oriented primarily to manufacturing (EUR 2 billion), financial intermediation and insurance (EUR 0.8 billion) and trade (0.6 billion). Also, reinvested earnings reached EUR 0.67 billion in the trade sector, EUR 0.65 billion in manufacturing and EUR 0.55 billion in financial intermediation and insurance. (BNR 2017, 7–8.) The FDI stock at the end of 2016 was over EUR 70 billion, distributed as follows: 44.2% in industry, 14% in construction and real estate transactions, 12.8% in trade, 12.6% in financial intermediation and insurance, 5.6% in professional, scientific, technical and administrative activities and support services, 5.2% in information and communications technology, 2.6% in agriculture, forestry and fishing, 1.7% in transportation, 0.6% in hotels and restaurants, 0.7% in other activities. Within the industrial sector, the largest investments were made in "manufacturing"—EUR 22.4 billion, followed by "electricity, gas and water"—EUR 6.7 billion and "mining"—EUR 1.8 billion. Also, the most attractive economic activities in manufacturing were "transport equipment" (6.7%), "oil processing, chemical, rubber and plastic products" (6.4%), "metallurgy" (4.1%), "food, beverages and tobacco" (3.4%), "manufacture of computer, electronic, optical and electrical products" (2.5%) and "machinery and equipment" (2.3%). (BNR 2017, 8–9.) The largest investments came from the Netherlands with EUR 17 billion, Germany—EUR 9.3 billion, Austria—EUR 8.3 billion,

France—EUR 4.8 billion, Cyprus—EUR 4.5 billion, and Italy—EUR 4.4 billion. The U.S. is only 13th (with EUR 1.35 billion) and the Russian Federation the 29th (with only EUR 0.14 billion). In the top 15 investors with FDI around EUR 1 billion and more, there are 14 countries in Europe, including 13 in the EU. (BNR 2017, 13.)

Starting with 2001, when FDI began to boost in Romania, there was also a phenomenon of repatriation of the profits made by foreign companies on the national territory. Over the last 16 years (2001–2016), about EUR 33 billion left the country in the form of income from FDI. (Pâslaru 2018) 2013 was the first year when Romania became a net exporter of capital—profits transferred abroad were with EUR 0.2 billion higher than FDI inflow. In 2015 and 2016, the capital deficit increased to EUR 0.7 billion and EUR 2.1 billion. According to an analysis carried out by "Ziarul Financiar" (a financial newspaper) and the Romanian Employers' Ownership in 2016, the companies with foreign capital held about 97% of the manufacture of coke and refined petroleum products and the manufacture of motor vehicles. (Ziarul Financiar–Patronatul Investitorilor Autohtoni 2018) Significant shares of foreign companies are recorded in the telecommunications and manufacture of electrical equipment (84%), metallurgy (82%), beverages production (81%) and manufacture of machinery and equipment (80%). Also, other major sectors of the national economy are controlled by over 70% of foreign capital, such as: extraction of crude petroleum and natural gas; manufacture of computer, electronic and optical products; rubber and plastics products production; manufacture of textiles. Neither the chemical industry production nor supply of electricity, gas, steam and air conditioning, the wood and pharmaceutical industries are any longer dominated by companies with Romanian private capital. The national companies still maintain their supremacy in sectors, such as: specialised constructions and agriculture (over 80%), human health services (74%), land transport and transport via pipelines, forestry and logging, manufacture of food products (over 60%), wholesale, retail and manufacture of furniture (55–58%).

Since 1989, the EU's non-reimbursable financial assistance has been concentrated in three instruments—PHARE, ISPA, SAPARD—designed to support the Central and Eastern European (CEE) Candidate Countries for the European Community. Thus, in September 1990, the European Council adopted the Regulation (CEC 1990) by which the PHARE Program for economic aid is extended to Romania. Since 1997, when Romania officially became an EU Candidate Country, the program has also been geared

towards supporting the accession process, in particular: minorities, public administration reform, justice, public finances, agriculture and development, environmental protection, management borders, economic and social cohesion, cross-border cooperation and a neighbourhood program. Between 1991 and 2006, Romania was granted about EUR 3.5 billion through the PHARE program and about EUR 700 million through bilateral assistance agreements with EU Member Countries. (Chioveanu 2008) Also, ISPA was oriented towards financing major transport and environment infrastructure projects and SAPARD towards financing structural reform in the field of rural development and in support of agriculture. Between 2000 and 2006, the funds allocated to Romania amounted to EUR 1,840 billion through ISPA and EUR 1,143 billion through SAPARD. (Chioveanu 2008)

In the 2007–2013 programming period, Romania received more than EUR 5 billion from EU Structural and Cohesion Funds, with a maximum of EUR 2.88 billion in 2013. Moreover, the amounts requested to the EC for reimbursement exceed EUR 3.56 billion compared to only EUR 1.65 billion in 2012 or EUR 0.75 billion in 2011. The absorption rate increased rapidly in 2013 due to the measures implemented by the Romanian Government, reaching 33.47% of the total structural and cohesion funds at the end of the year allocated to the country during the period of 2007–2013. At the end of April 2012, the absorption rate was only 8.53%. (MFE[22] 2013) According to the data from the Romanian Ministry of European Funds, Romania received in 2007–2013 more than EUR 37 billion from Brussels, of which EUR 2.7 billion were from the pre-accession funds and EUR 34.3 billion came from the money that were allocated post-accession. Within these post-accession funds, the most significant ones were those for: rural development and fisheries (including rural road networks; irrigation equipment; agriculture, aquaculture and fisheries projects, etc.)—EUR 7.73 billion with an absorption rate of over 90%; direct payments/hectare—over EUR 7.65 billion; structural and cohesion funds (including roads, railways, landfills, sewerage, social projects, private sector investments, research projects, institution development, etc.)—EUR 17.25 billion with an absorption rate including advances from the EC of 89.13%. (Zamfir 2017) These high rates of absorption of European funds are a sign of the stability of the economic and financial environment and have given a positive signal to foreign companies and investors.

[22] MFE: Ministerul Fondurilor Europene (en – Ministry of European Funds).

For the 2014–2020 programming period, Romania was granted with EUR 43 billion, distributed as follows: Cohesion Policy—about EUR 22.7 billion; Common Agricultural Policy and Fisheries—EUR 7.8 billion; European Agricultural Guarantee Fund—EUR 10.4 billion and the performance reserve—EUR 1.9 billion. By 2016, Romania had accessed EUR 3.5 billion, of which EUR 1.35 billion of structural and cohesion funds, EUR 0.6 billion of funding for rural development and fisheries and EUR 1.18 billion of direct payments/hectare. Also, according to the most recent statistics from the Romanian Ministry of Public Finance, between January 2007 and December 2016, the country received EU non-reimbursable funds of over EUR 40.87 billion while the national contribution to the EU budget was about EUR 13.78 billion euros, which means a net surplus of almost EUR 27.1 billion. (MFP[23] 2017)

The Socioeconomic Effects of Integration

Since 1990, the migration of skilled and, especially, unskilled labour force has seen some milestones: the regulation of the right to freely travel abroad from 1990–1991, (CFSN 1990a) the abolition of Schengen visas in 2001, the accession of Romania to the EU at 1 January 2007 and the strong growth of the national economy from 2006 to 2008. As we can see, the crude rate of net migration registered a sharp increase in the number of exits exactly at the moments described above (–17.6% in 1991, –25.2% in 2001, –21.9% in 2007), which demonstrates that the removal of some restrictions or the periods of economic expansion will increase the volume of migration (Figure 7). The effects of the 2008 economic and financial crisis on the European continent over the next five years led to a gradual decline in Romanian migrant flows from a rate of –8% in 2008 to just –3% in 2016.

[23] MFP: Ministerul Finanțelor Publice (en – Ministry of Public Finance).

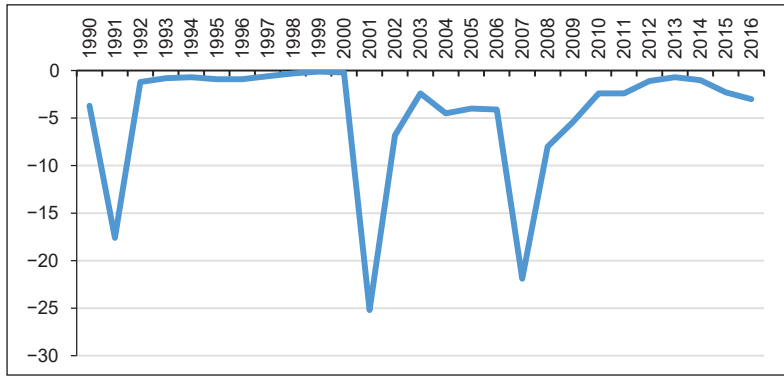


Figure 7.
The evolution of the crude rate of net migration in Romania between 1990 and 2016

Source: Eurostat s. a.c

Immediately after 1989 there was a massive emigration flow of the unskilled labour force and some of the experts from the vital areas of the Romanian society and economy (professors, engineers, doctors, researchers, IT experts, etc.), which affected almost all domains of life and society and prolonged the transition process. For example, between 1990 and 2015, about 21,000 doctors chose to work abroad (14,100 after 2007), especially in Germany, France and the U.K. (Moraru 2016) According to the latest UN estimates, between 3.5 and 4 million Romanian citizens are settled abroad, of which 2.8 million live and work in other EU Member States, especially Italy—about 1.15 million and Spain—0.9 million. (MRP[24] 2017) We highlight the fact that emigration represents not only a potential security challenge for Romania, but also a source of financial benefits in terms of remittances and, in some cases, increasing the standard of living of the emigrants' families and communities. Between 1994 and 2016, the remittances sent by Romanian citizens working abroad amounted to USD 26.2 billion, with a maximum of USD 4.7 billion in 2005. (WB 2017a) Starting in 2013, remittances have consistently reached USD 3–3.5 billion a year, which means a contribution of 1.70–1.85% in GDP.

[24] MRP: Ministerul pentru Românii de Pretutindeni (en – Ministry for Romanians Abroad).

Following the EU membership, there has been a massive increase in the number of Romanian migrants looking abroad for better life and working conditions,[25] which has unbalanced the labour market generating large deficits in some economic sectors. If the period until 2007 was predominated by the departure of those with a low and average qualification who worked mainly in agriculture, after 2007 there was an increase in the high skilled labour force (brain drain). Thus, by the end of 2016, we know about the record of the highest number of vacancies (59,800) since 2008, of which 9,700 in public administration, 8,500 in the health and social care and 2,500 in education. (INS 2017c) The main causes of skilled labour migration are the less attractive salary package in these areas and the existence of much more tempting alternatives in the domestic private sector or abroad. Another important effect of this labour-intensive migration has been the sustainability of the social protection system of the labour market in Romania and the EU 27, conditioned by active integration and effective participation through contributions to these systems for Romanian citizens working on the territory of other EU Member States. (GR 2014)

Conclusion and Outlook: Drawing the Balance of the Results of Integration

Romania had a rough start on the path of integration into the European and Euro-Atlantic structures. It has lost about a decade of development and the 1990–1991 performance of the national economy was reached only in the 2000s. In all of these years, Romania's political and economic uncertainty and geostrategic transition status has fuelled foreign investors' reluctance to assume long-term commitments and projects. As soon as the strategic direction of joining NATO and the EU was agreed both by decision makers and population, foreign capital in Romania began to increase and economic growth began to recover. Romania became a member of NATO in 2004 and the EU in 2007, demonstrating that Romania is a safe and predictable European country in an area characterised by multiple challenges and uncertainties. In the ten years period since joining the EU, the national economy has steadily developed due the implementation of

[25] In 2014, the U.K. was the last EU Member State to lift restrictions on Romanian and Bulgarian workers.

measures and actions to strengthen European integration and to assimilate and promote the principles and values on which it is based. Thus, we can see that FDI and the number of European companies operating on national territory have increased, trade with EU Member States has raised strongly, absorption of European funds has improved visibly, and skilled labour has unrestricted access to the EU labour market. All these positive results show that the integration process was a successful one, so 10 years after accession, the Romanian population's confidence in the EU continues to be above the European average (52% vs. 36%). (EC 2016)

Looking ahead, it is intended to increase and strengthen the profile and role of Romania within the EU, under the conditions created by the entry into force of the Treaty of Lisbon. Taking into account that Romania will hold the presidency of the Council of the European Union in the early 2019, further economic integration and rebalancing interdependence will be a priority. In order to enhance the role of Romania as EU Member State and to move to real integration, according to the Government, Romania must take several important actions. One of them is active participation in the debate on the future of the European project and EU decision-making process, with the consistent promotion of the strategic objectives and interests of Romania and its citizens, with emphasis on stimulating economic growth and employment, economic and social cohesion. Another important step is the contribution to enhanced cooperation in the EU, including the more efficient use of Eastern Partnership, EU Strategy for Danube Region, Black Sea Synergy instruments. Regarding the convergence instrument, Romania must focus on Cohesion Policy and the Common Agricultural Policy, starting from the premise of the added value of these policies for the whole European Single Market. Also, there must be a strong support at European level regarding the policies that respond to the competitiveness model chosen for Romania, focused on industry and services. Another important action in the economic area is the avoidance of increasing gaps between euro and non-euro countries in the context of deepening economic governance of the euro area.

In addition to the economic issues, there is another important area that marked Romania's European integration, namely the security one. In this respect, it is very important that Romania maintains the commitment to join the Schengen Area in order to contribute to strengthening the security of the EU's external borders since it is one of the states at the Eastern border. Also, this country has an important role regarding the energy security of Europe

and that is why it must promote its interests in achieving energy security, including by funding the projects of the Southern Corridor (Nabucco-West pipeline, Azerbaijan–Georgia–Romania Interconnector, etc.).

Therefore, Romania did not simply remove the Communist regime and entered a period of continued economic growth, but rather had good and bad times, striving to achieve political stability, to develop the living conditions for its population, to increase the GDP value, etc. During the 1980–2016 period of time, the purpose of Romanian leaders was not only to fulfil all of the criteria for European integration, but also to consolidate its strategic credibility, meaning predictability, and building security, consolidated democracy and the rule of law.

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Vákát oldal

Chapter 7.

Economic Integration and Interdependence in Slovakia

An Automotive Powerhouse with an Uncertain Future

Tomáš Meravý

The Conditions at the Beginning of the Integration Process

The main driver of high economic growth in Slovakia since gaining independence in 1993 has been foreign direct investment. Slovakia currently ranks number one globally in per-capita car production. A skilled labour force, low wages and tax rates, membership of the euro area, and a favourable geographic position have been the main reasons behind the Foreign Direct Investments (FDI) inflows. The weak points of the Slovak model are a negative net investment position, a negative balance of primary income, a high degree of export dependence, and low R&D intensity. Demographic prospects linked to ageing pose a long-term challenge to prosperity. Investing into childcare, science and education are necessary to direct Slovakia towards a more balanced and sustainable growth.

Slovakia became independent in 1993. The Association Agreement with the EU was signed in the same year and came into effect in 1995 after having been ratified by all member states. Full membership of the EU was accomplished in 2004, the adoption of the euro followed in 2009. Since 2001, Slovakia has also been a member of the OECD.

Slovakia was still part of the Czechoslovak Socialist Republic when the Velvet Revolution swept the Communist Party from power in 1989. Soon after the events of November 1989, when mass demonstrations and a general strike paralysed the power of the central apparatus, differences in priorities between the more prosperous, urbanised Czech lands and the

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poorer, more rural Slovak part of the common state became apparent. A drive for more autonomy developed in Slovakia, which ultimately led to the peaceful dissolution of Czechoslovakia and the formation of two independent states in 1993. In the field of economic policy, the differences materialised in a notably pro-market approach in Czechia, and a more nationalist approach in Slovakia.

The newly formed Slovak Republic started its path towards European integration in 1993 at a disadvantage to its western neighbour. The figures in Table 1 show that Slovakia trailed its western counterpart from the start in virtually every key economic indicator. Initially, confidence in the newly formed Slovak state was low; the Czech Republic attracted considerably higher levels of foreign direct investment per capita not just in the initial phase, but practically throughout the entire 1990s.

Table 1.

Economic conditions of the newly independent Czech and Slovak states in 1993

Indicators	Czech Republic	Slovakia
HDI score	0.872 (37.)	0.864 (41.)
GDP growth (%)	–0.9	–4.1
GDP (billions of USD)	124.6	39.6
GDP per capita (USD)	12,062	7,430
Inflation (%)	20.8	23.2
Unemployment rate (%)	3.5	14.4
Export/import ratio	1.027	0.86
FDI (billions of USD)	2,7	0.6
FDI (USD per capita)	261	112
Public finance surplus/deficit (% of GDP)	0.1	–6.8

Source: OECD s. a.; NBS[26] s. a.a

The relative position of the Slovak economy at the start of the integration process can further be demonstrated by GDP per capita in purchasing power parity in relation to Europe. According to Eurostat, GDP per capita (PPP) in Slovakia in 1995 reached 48% of the European average (current EU28 composition) and around a third of Western European levels. Slovak GDP per capita in 1995 was lower than that of the Czech Republic, Slovenia

[26] NBS: Národná Banka Slovenska (en – National Bank of Slovakia).

and Hungary, but higher than most Central and Eastern European (CEE) countries. The relative position of Slovakia in economic performance has seen much improvement due to a period of rapid economic growth following EU accession (Figure 1).

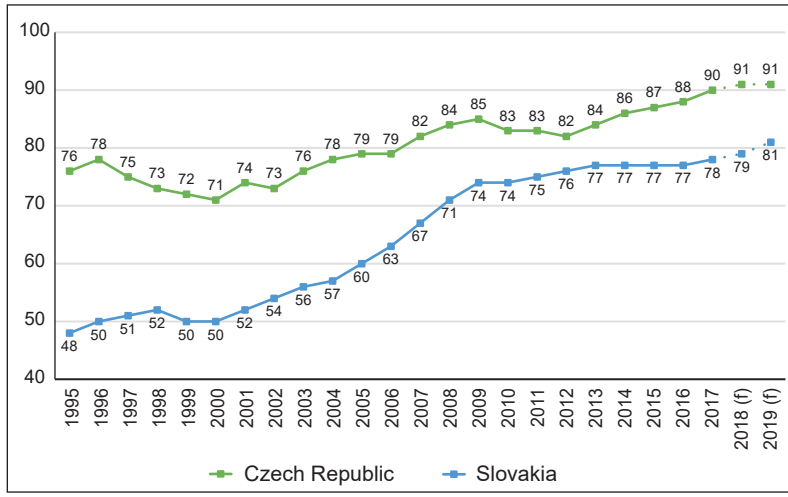


Figure 1.
GDP per capita in PPP (% of EU28 level)

Source: EC[27] s. a.

Interdependence and Economic Penetration

Foreign trade proved to be a lifeline for Slovakia and played an important role in turning around the fortunes of the Slovak economy in the upcoming years. Inside the Czechoslovak federation, Slovakia supplied the more advanced Czech economy with semi-finished goods, and export from Czechoslovakia to EU countries was rapidly rising from 1990 onwards. Therefore, Slovakia's export was already geographically oriented towards the west when the country achieved independence (Figure 2).

[27] European Commission.

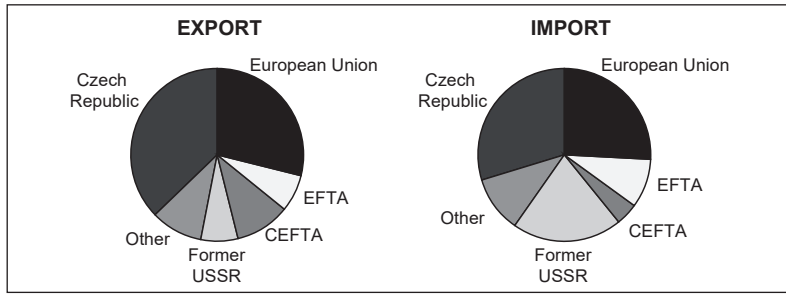


Figure 2.
Territorial structure of the Slovak foreign trade in 1994
Source: NBS s. a.a

Initially, the Czech Republic was the dominant trading partner; it formed a third of Slovakia's export and more than a quarter of its imports. On the import side, the Russian Federation was a major supplier of oil and natural gas and an important overall import partner with roughly a fifth of total Slovak imports. Second in importance after the Czech Republic were EU countries both in exports and imports; the strong growth in trade to the EU meant that they soon displaced the Czech Republic as the foremost trading partner. To be precise, Germany became the dominant trading partner and displaced the Czech Republic to second place, followed by Poland, Hungary, Austria, France, the United Kingdom, Italy and other EU economies (Table 2).

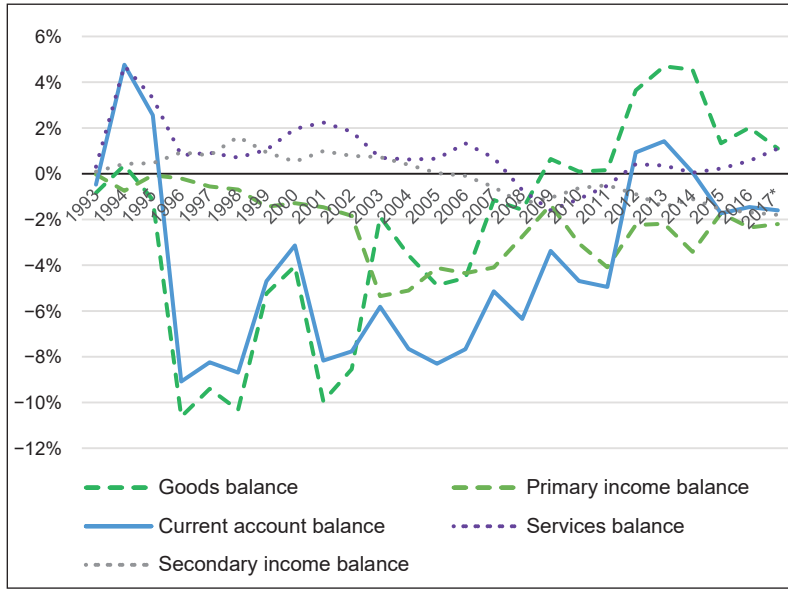
Table 2.
Largest trading partners of Slovakia in 2017 by share on total trade (%)

Exports		**Imports**	
EU	85.4%	EU	66.9%
Germany	20.6%	Germany	16.5%
Czech Republic	11.5%	Czech Republic	10.2%
Poland	7.6%	China	7.3%
France	6.3%	South Korea	5.7%
United Kingdom	6.0%	Poland	5.2%
Italy	6.0%	Hungary	4.8%
Hungary	6.0%	Russia	4.7%
Austria	6.0%	Italy	3.2%
Spain	2.9%	France	3.2%
United States	2.8%	Austria	2.8%

Exports		Imports	
Netherlands	2.6%	United Kingdom	2.5%
Russia	2.0%	Spain	1.5%
China	1.6%	United States	1.1%

Source: ŠÚ SR[28] s. a.

In the initial years after gaining independence, there was a decline in the importance of exports to the economy. The reason for this was that the Mečiar Government attempted to stimulate economic growth through public expenditure projects while retaining domestic and state ownership of large enterprises, which worsened the current account balance, while an unfavourable business climate hampered FDI inflow and thus exports grew more slowly than GDP (Figure 3).



*2017—only 3rd quarter data.

Figure 3.

Current account balance, Slovak republic (% of GDP)

Source: NBS s. a.b

[28] ŠÚ SR: Štatistický úrad Slovenskej republiky (en – Statistical Office of the Slovak Republic).

This trend was only reversed after 1998, which was brought about by a reorientation of the economic policy towards attracting FDI into export industries. Since then, Slovakia witnessed a dramatic increase in nominal export value, as well as a growing importance of exports to the overall economy (Figure 4). Throughout the 1990s, the share of exports destined to other EU countries (in today's composition) has been steadily increasing, and reached its apex in 2001 (90.6%). Since then, the share has been slowly declining; the share of EU exports in 2017 has reached 85.4%. On the import side, the European Union is also the dominant partner, but to a slightly lesser extent. In 2000, the share of Slovak imports from the EU was at 70.2%. The historic apex of this figure was in 2005, when it reached 77.8%; by 2017 it has somewhat decreased again to 66.9%. Thus we can say that the European Union remains the dominant trading partner for both exports and imports.

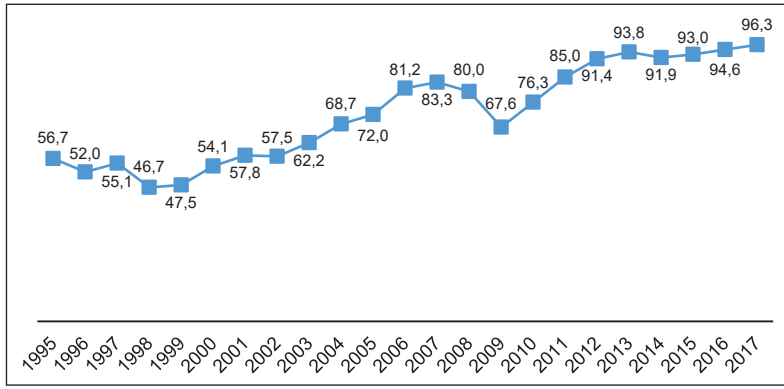


Figure 4.
Slovak exports of goods and services in relation to GDP (%)

Source: Eurostat s. a.a

On the import side, Russia is an important partner for oil and natural gas imports, but its overall importance for imports has dramatically decreased from 17% to less than 5% as Slovakia's economy has grown and diversified. On the other hand, we can observe a steady rise in imports from China and South Korea. The import shares of Germany and the Czech Republic have decreased, but these two countries have remained the two most important trade partners for Slovakia (Figure 5).

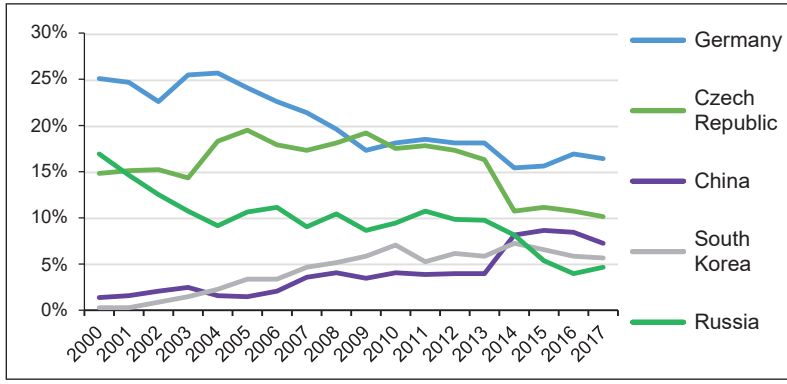


Figure 5.

Share of imports of selected trading partners, Slovak Republic (%)

Source: ŠÚ SR s. a.

The bulk of Slovak exports, which rose between 1995 and 2016 by a factor of 8.5 in nominal terms and by a factor of 5.5 in real terms, were automobiles and automobile parts, consumer electronics, industrial machinery and iron and steel production (Figure 6).

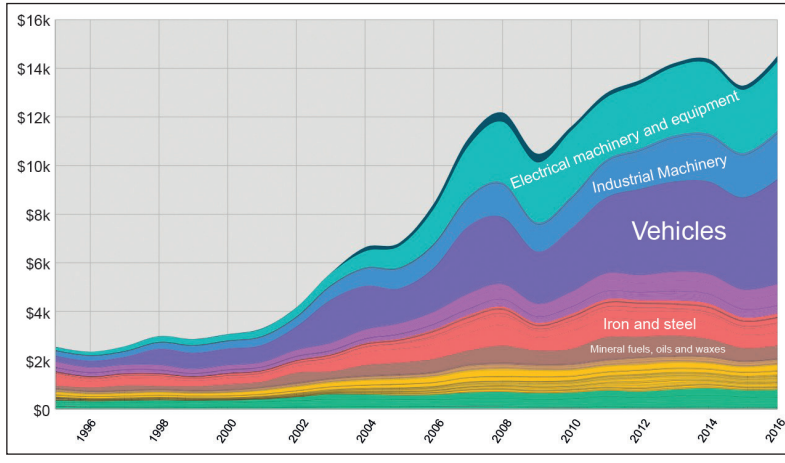


Figure 6.

Per capita exports of goods of the Slovak Republic, adjusted for inflation

Source: Harvard University 2016

The rapid increase of exports of these products was driven by foreign direct investment in export-focused industries. Some of the large automotive investors already established in Slovakia are Volkswagen, PSA and Hyundai–Kia. In 2015, the decision to build a fourth car plant near Nitra was made by Jaguar Land Rover; production at the facility should commence in late 2018. With over 1 million cars produced in 2017, Slovakia currently leads the world in per capita car production. The country is also home to a web of automotive parts suppliers, machinery producers, metallurgic and wood-processing enterprises. Shared service centres, foreign-based retailers and banking groups are a dominant feature of foreign investment. Besides the car industry, large investments of electronics and home appliance manufacturers like Samsung, Sony, Foxconn and Whirlpool are also present. Companies from several countries appear among the investors in Slovakia (Table 3).

Table 3.
Inward FDI stock in Slovakia by country of origin in 2016

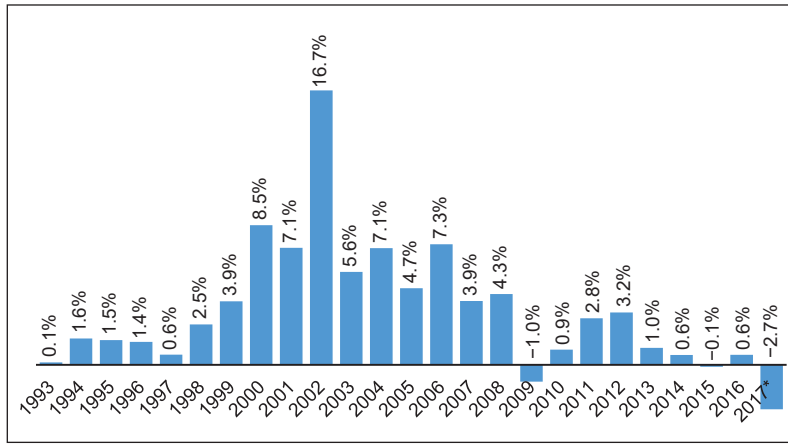
Country of origin	FDI stock (million EUR)	Share
Netherlands	10,282,346	24.8%
Austria	6,644,347	16.0%
Czech Republic	4,844,377	11.7%
Luxembourg	4,414,644	10.6%
South Korea	2,918,877	7.0%
Hungary	2,269,985	5.5%
Belgium	2,223,222	5.4%
Germany	2,161,787	5.2%
Cyprus	1 654 852	4.0%
Italy	877,990	2.1%
Other	3,204,072	7.7%

Source: NBS s. a.c

The bulk of these manufacturing enterprises are situated in western Slovakia, which is not just the most urbanised part of the country, but also the best endowed with infrastructure and human capital. In Eastern Slovakia, the city of Košice and the village of Kechnec were also large beneficiaries of FDI inflow. The most significant investment in eastern Slovakia was made by American multinational US Steel, who have purchased a near-bankrupt steel mill in 1998. The mill was originally

constructed in the 1960s during the Communist era but sold to domestic entrepreneurs in the early 1990s.

The bulk of foreign investors in Slovakia have arrived in the 2000s, which saw the largest inflow of FDI into the country (Figure 7). A considerable part of that investment was driven by the privatisation of formerly state-owned enterprises, especially banks, telecoms and utilities. These sectors are now largely in foreign hands. As has been mentioned earlier, throughout the 1990s Slovakia was not particularly attractive to foreign investment in comparison to neighbouring countries because the Mečiar cabinets were prioritising domestic privatisations and the business climate was not very reliable. The unusually large inflow of FDI in the following period was therefore merely the manifestation of a dramatic catching-up process.



*2017—only 3rd quarter data.

Figure 7.

Foreign direct investment balance of Slovakia (% of GDP)

Source: NBS s. a.d

The robust FDI inflow was instrumental in decreasing unemployment levels, raising living standards and improving the formerly substantial deficit of the current account (Figure 8). This was not accidental but a cornerstone of government economic policy in the 1998–2016 period. A lack of domestic capital and know-how was to be compensated by importing large stocks of foreign capital, to which the tax and labour codes were tailored.

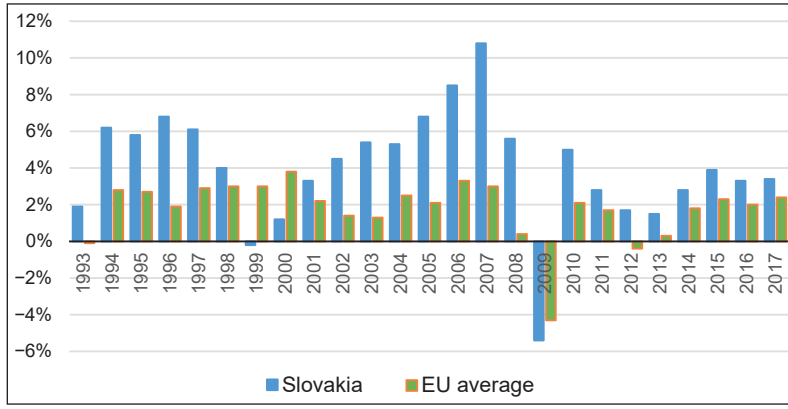


Figure 8.
Annual GDP growth

Source: Eurostat s. a.b; NBS s. a.d

Despite the obvious success of this model, there are some deficits. Large inflows of foreign investment coupled with an especially weak domestic capital basis resulted in a markedly negative net investment position of the country amounting to 48% of GDP (Figure 9). The balance is quite one-sided even in comparison with other CEE countries. Slovakia lacks large domestically based companies, hence the ability of domestic capital to reach outwards is very limited.

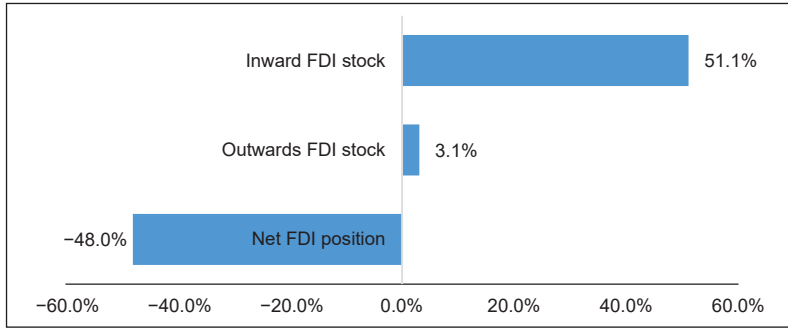


Figure 9.
Slovakia's FDI stock and net investment position in 2016 (% of GDP)
Source: Eurostat s. a.c

A consequence of Slovakia's development model is the formation of a so-called dual economy. Economic growth has been chiefly driven by a relatively small number of large, foreign-owned enterprises, but the bulk of employment is provided by less technologically advanced SMEs. According to Eurostat, Slovakia has some of the largest shares of employment (26%) provided by foreign companies (Figure 10).

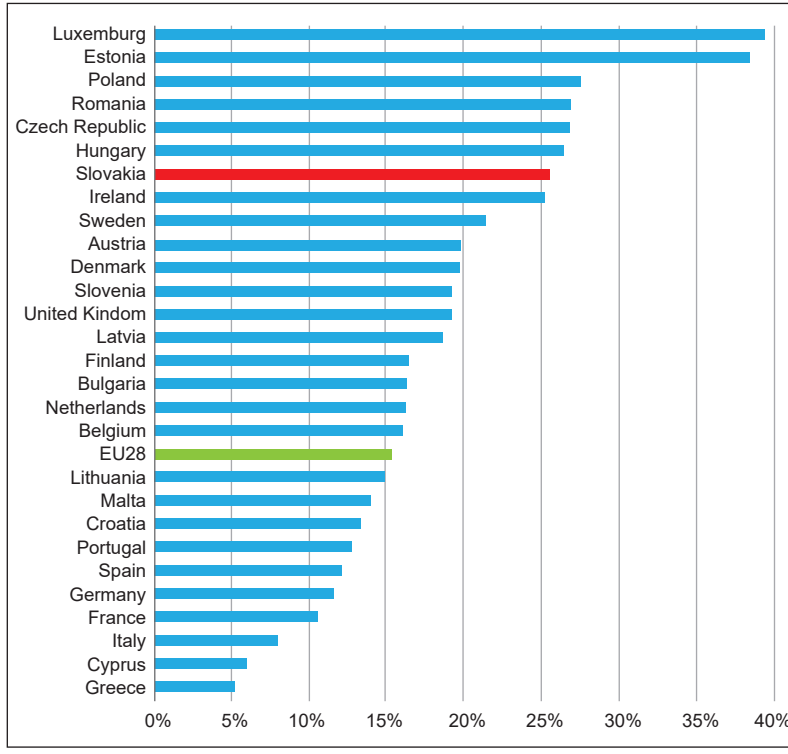


Figure 10.

Share of foreign companies on total domestic employment, 2014

Source: Eurostat 2018a

While offering substantially better pay than domestic enterprises and the public sector, foreign investors in Slovakia often do not pass over a substantial part of value added to their workers in the form of workers compensation since their compensation levels are accommodated to Slovak wage levels.

Trade unions in Slovakia are traditionally rather weak, thus workers' ability to bargain with large employers for wages and other working conditions is limited. Collective bargaining in Slovakia takes place predominantly at company level. While there are active and well organised trade union organisations present at the largest industrial enterprises (i.e. car plants), they are very weak in the services sector (Figure 11).

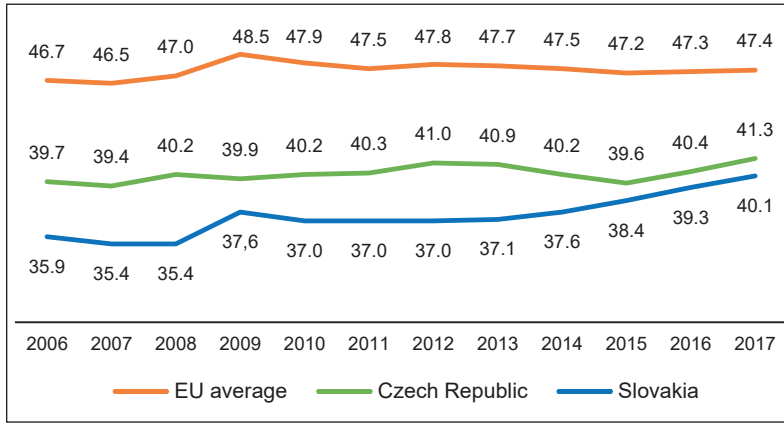


Figure 11.
Compensation of employees (% of GDP)

Source: Eurostat 2018a

This may be one of the reasons why worker compensation in industries like banking and telecoms is relatively low, given the productivity of the sector. For instance, most banks present in Slovakia only pass off one third of value added to their workers as wages, while two thirds remain in the form of gross profit. In more mature labour markets of Western Europe, the ratio is usually reversed: two thirds of value added are paid out as wages and only one third remains as profit of the shareholders. Another plausible reason for low bargaining power of workers may be, of course, that the rate of unemployment in Slovakia has traditionally been quite high and has only fallen to levels close to the EU average in late 2017. The recent fall in the unemployment rate coincides with an increase in the share of worker compensation on GDP.

The effects of euro adoption have been debated in Slovakia right after the financial crisis, but as of today, euro membership of Slovakia is not an

issue. Slovakia joined the euro area on 1 January 2009, which was just after the outbreak of the 2008 Financial Crisis and the following Great Recession. During these, Slovakia's neighbours experienced significant exchange rate depreciations of up to 30%, which cushioned the immediate impact of the recession on their export-oriented economies. On the other hand, the necessity to cut costs in the face of a fixed exchange rate with most export markets may have led establishments in Slovakia to cut their workforce more aggressively then neighbouring countries and focus on increasing productivity to keep pace with competition (Figure 12).

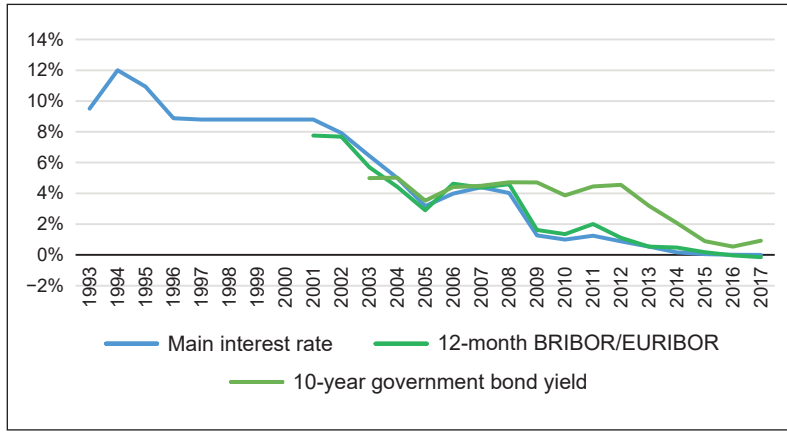


Figure 12.
Interest rates in Slovakia

Source: NBS s. a.d

The Slovak labour market did in fact experience a more violent reaction to the recession than other V4 economies, with the unemployment rate climbing by as much as 6% between September 2008 and March 2010 (Figure 13). The effects of the euro adoption on long-term GDP growth and labour productivity may therefore be positive, but with a negative effect on employment. The Inštitút finančnej politiky (IFP) (Institute of Financial Policy) at the Slovak Ministry of Finance has estimated that the euro increased Slovak GDP by 10%, but most of this effect had already been realised prior to 2009 in anticipation of Slovakia joining the euro. The IFP also concluded that the absence of a floating exchange regime worsened the performance of the Slovak economy during the Great Recession by 2%. (IFP s. a.a)

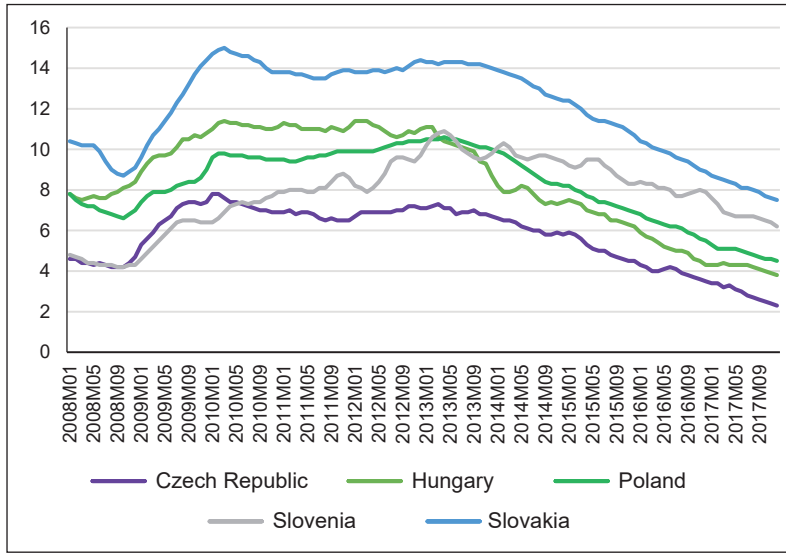


Figure 13.
Harmonised unemployment rate (%)

Source: Eurostat s. a.d

Another effect which may prove to be a double-edged sword is the effect of reduced interest rates on the economy. As noted before, one of the benefits of Slovakia joining the euro was the adoption of the common monetary policy of the European Central Bank (ECB), which provided for lower inter-bank and commercial interest rates. In the euro area, due to the expansive policy of the ECB, the main interest rate after the Great Recession has fallen to zero. Long-term interest rates on government debt have fallen below 2%. Slovakia, being a member of the euro, is subject to stricter macroeconomic surveillance and enforcement of fiscal discipline after the reform of the Stability and Growth Pact (the so-called Sixpack), the signing of the Euro+ Pact, and the Fiscal Compact in 2011–2012. The reason why the interest rate reduction may prove to be a double-edged sword lies in the effect on household balance sheet.

In recent years, historically low interest rates coupled with a somewhat immature, unsaturated housing market, as well as government support of home ownership, have fuelled a mortgage boom and sharply increased

housing prices (Figure 14). The rapid increase in household debt, fuelled mainly by mortgage loans, has already led the National Bank of Slovakia, which sees risks to household liquidity in the case of a market correction, to restrict access to mortgages. A factor which compounds the risk is the fact that the household savings rate in Slovakia has traditionally been rather low, and although it has recently risen to approximately 9%, is still below EU average. The threat to household balance sheets have, however, so far not realised because the country is yet to enter the top of the economic cycle (economic growth is expected to accelerate to above 4% in 2018 and 2019 due to enlarged automotive facilities).

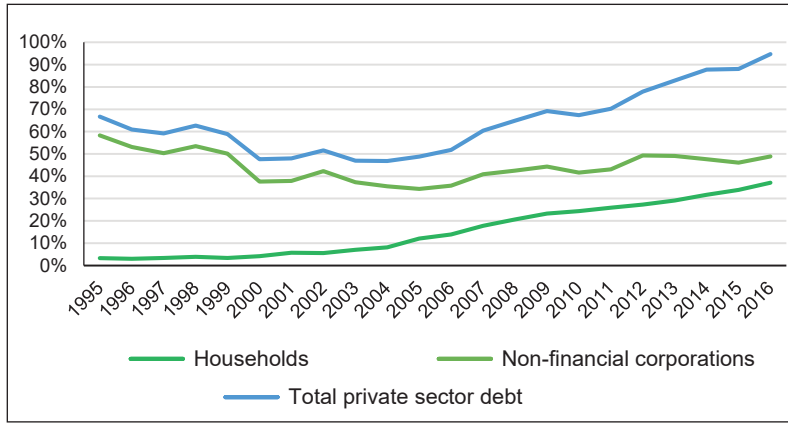


Figure 14.
Private sector debt in Slovakia

Source: Eurostat s. a.e

Somewhat surprisingly, Slovakia's extremely negative investment position does not correspond with relative low levels of primary income deficits in the current account balance (Table 4). The long-term average for the primary income deficits in 2006–2016, for which withdrawal of dividends by foreign multinationals are chiefly responsible, stands at just 2.4% of GDP, which is relatively low. This is unusual but may have a plausible explanation. An explanation for this may probably lie in transfer pricing strategies of large industrial enterprises present in Slovakia, thus the channel of profit withdrawal would not be the primary income balance, but rather the trade in goods and services balance.

Table 4.
Primary income balance for 2006–2016 (% of GDP)

Countries	Credits	Debits	Balance
Czech Republic	3.7%	9.3%	–5.5%
Hungary	11.5%	16.0%	–4.5%
Estonia	6.0%	10.0%	–3.9%
Bulgaria	2.1%	5.4%	–3.5%
Poland	2.8%	5.8%	–3.0%
Croatia	2.3%	4.9%	–2.7%
Lithuania	2.5%	5.1%	–2.6%
Slovakia	4.4%	6.8%	–2.4%
Romania	1.6%	3.6%	–2.1%
Slovenia	3.1%	4.9%	–1.8%
Latvia	5.3%	5.7%	–0.3%

Source: Eurostat s.a.f

Unlike e.g. groceries, banks and insurance companies whose revenue is derived from sales, fees and interest income originating in the domestic market, large industrial establishments like car factories and electronics manufacturers sell their produce mainly to their parent companies who handle marketing and sales to export markets for the entire group. Slovak tax legislation applies the arms' length principle to transactions between domestic as well as foreign related parties for tax purposes, but this does not mean that transfer pricing in practice is altogether eliminated. Typically, a company which sells produce to its foreign owner would apply below-market prices for its produce, resulting in reduced reported revenue, but make up for this in the tax return and transfer pricing documentation supplied to the tax authority, thus paying the correct amount of tax. Underreporting revenue in the annual statements makes bargaining for higher wages by the in-house trade union difficult because the real profitability of the company is unknown. Transfer pricing policies are often accompanied by utilising loans, management fees and royalties instead of standard dividend pay-out schemes as means of profit withdrawal. The scale of profit withdrawal from the country could be a lot larger than what can be observed from simply looking at the figures presented in the current account balance. Unfortunately, it is practically impossible to precisely determine the exact impact of these practices on private sector profitability, current account balance and gross domestic product from publicly disclosed sources alone.

Slovakia's model of FDI-, export-driven economic growth is based on several key advantages. The first is membership not just of the European Union, but from 2009 on also of the euro area, which eliminated exchange rates fluctuations and reduced interest rates. This, together with a favourable geographical position and good infrastructure has made western Slovakia an ideal region for establishing export-oriented manufacturing facilities. An important advantage is a skilled and relatively cheap labour force, which result in a favourable labour costs/productivity ratio (Figure 15). While labour costs have risen strongly and are now among the highest in the CEE countries, they still compare favourably to labour productivity. Labour productivity per hour worked in PPS in 2016 reached 81.7% of the European average, whereas labour productivity per hour in nominal exchange standards reaches 55.6% of the EU average. (Eurostat 2018b) Total nominal labour costs per hour in euro are yet lower, at around 44% of the EU28 average. Therefore, we can say that unit labour costs in Slovakia are still favourable in comparison to productivity and towards labour costs in the rest of Europe. However, from the numbers it is obvious that this advantage is slowly diminishing as labour costs are rising, unemployment rates are falling, and the pool of skilled labour is diminishing. In western Slovakia in particular, companies are already complaining about a fundamental lack of skilled labour as the levels of unemployment in some western regions has reached as little as 3%, which pushes up wages.

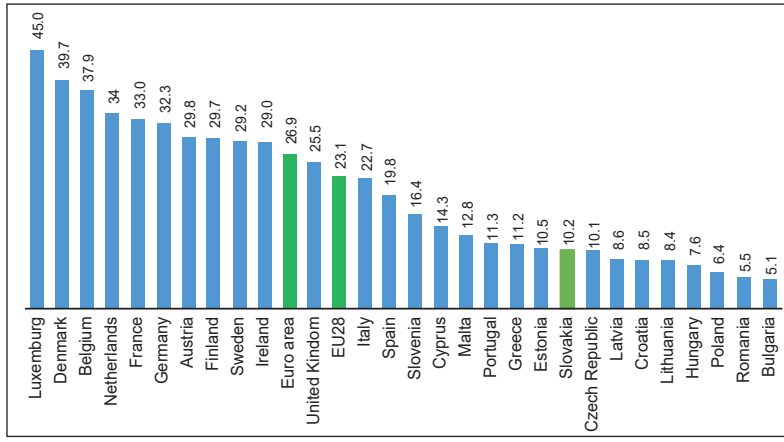


Figure 15.

Nominal labour costs per hour worked in 2017 (EUR)

Source: Eurostat 2018b

Finally, another advantage which Slovakia offers to investors, but which is also slowly diminishing, is low tax rates. Public revenue and expenditure has been lower than in the rest of the euro area since around 2000 (Figure 16). Tax reform has been one of the key aspects of Slovakia's strategy in supporting investment and improving the business climate. However, this has mostly concerned business taxes as labour and consumption taxes have remained at relatively high levels. The rate of corporate income tax has been reduced to 25% from 40% between 1999 and 2002. In 2004, which coincided with Slovakia's accession into the European Union, the right-wing government launched a major tax reform, which replaced a progressive system with a flat tax of 19%. This rate applied to VAT, corporate as well as personal income tax. Dividend tax was abolished, which resulted in an extremely low level of capital income taxation. In addition to low tax rates, investors in Slovakia can make use of various government support schemes which include tax holidays.

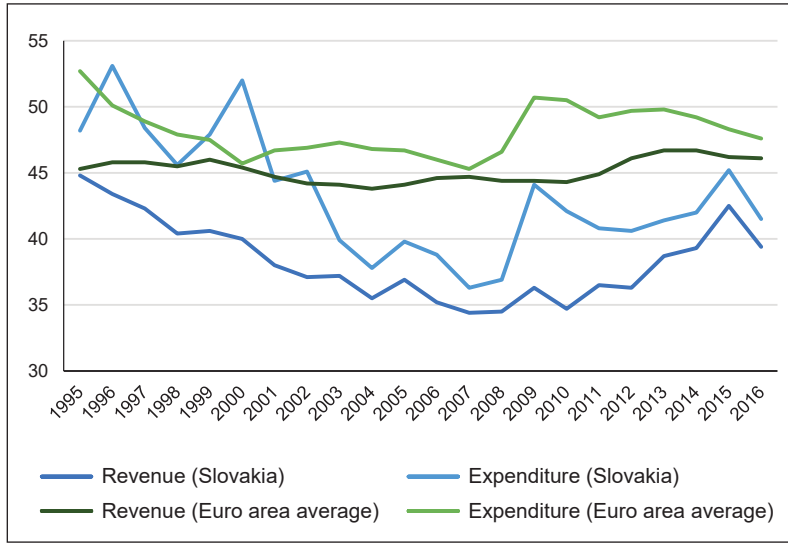


Figure 16.

General government revenue and expenditure (% of GDP)

Source: Eurostat s. a.g

The flat tax remained in place with only cosmetic changes until it was abolished in 2013 by a leftist government, but the changes were relatively moderate. Corporate tax has initially risen to 23% in 2013, but the rate has again fallen to 21% in 2017. Personal tax has seen the introduction of a higher tax bracket, to which a 25% rate applies, but this rate is rather low and currently only concerns yearly taxable income in excess of 35,268 euros, which is more than three times the average wage. Additional changes after 2013 included introducing payroll taxes to non-traditional employment contracts, increasing payroll tax ceilings, as well as the reintroduction of the dividend tax, currently at 7%. Despite these changes, Slovakia remains a relatively low-tax country, at least in a European context.

The Use of European Structural and Investment Funds

The financial support of the European Union in the form of the pre-accession funds, the Structural Funds and the Cohesion Fund has been an important part of Slovakia's development (Tables 5 and 6). During the candidacy period, starting from 1998 onwards, financial assistance to Slovakia came in form of pre-accession funds ISPA, PHARE and SAPARD. Yearly drawing of funds in this period averaged 1.4% of GDP. (MF SR[29] s. a.) After EU accession in 2004, support is coming chiefly from the Structural Funds and the Cohesion Fund, while drawing of pre-accession funds continued until 2007. Slovakia, being one of the poorer members of the EU, is a net benefactor from the EU budget, with a net yearly financial position of 2.7% of GDP. Slovak funding of the EU budget amounts to 1.1% of GDP, while total inflow of EU funds to Slovakia amounts to 3.8% of GDP based on the 2007–2013 period. (Úrad podpredsedu vlády SR pre investície a informatizáciu[30] s. a.)

[29] MF SR: Ministerstvo financií Slovenskej republiky (en – Ministry of Finance of the Slovak Republic).

[30] en – Office of the Deputy Prime Minister of the Slovak Republic for Investments.

Table 5.

Allocation and drawing of EU structural and investment funds in the Slovak Republic by operational programmes in the 2007–2013 programming period

Funded areas	Allocation in 2007–2013 (EUR)	Share
OP Education	542,728,860	4.7%
OP Employment and Social Inclusion	941,301,578	8.2%
OP Informatisation of Society	843,595,405	7.3%
OP Environment	1,820,000,000	15.8%
OP Regional OP	1,554,503,927	13.5%
OP Transport	3,160,154,595	27.5%
OP Healthcare	250,000,000	2.2%
OP Competitiveness & Economic Growth	968,250,000	8.4%
OP Technical Assistance	97,601,421	0.8%
OP Bratislava Region	95,207,607	0.8%
OP Research and Development	1,209,145,373	10.5%
Total	11,482,758,666	100.0%

Source: Úrad podpredsedu vlády SR pre investície a informatizáciu s. a.

Currently, around 80% of public investment in Slovakia is dependent on the EU's financial support, and the impact on economic growth is estimated at 0.9% of GDP annually. (Úrad podpredsedu vlády SR pre investície a informatizáciu s. a.) The total allocation of funds from the Structural Funds for the 2007–2013 programming period, which was the first period to which Slovakia had full access as an EU member during the whole period, was EUR 11.5 billion, which equals to 2.44% of Slovakia's GDP. Out of this amount, only a total of EUR 8.1 billion (70% of available funds) was successfully implemented by the end of April 2015. Due to the prolongation of drawing from the 2007–2013 period by the European Commission, the absorption rate for the period of 2007–2013 has reached 97% in the end.

Table 6.

Allocation of European structural and investment funds for the Slovak Republic in the 2014–2020 programming period

Funds	Allocation (EUR)	Share
European Regional Development Fund	7.36 billion	48.0%
Cohesion Fund	4.17 billion	27.2%
European Social Fund	2.17 billion	14.1%
European Agricultural Fund for Rural Development	1.55 billion	10.1%

Funds	Allocation (EUR)	Share
European Maritime and Fisheries Fund	16 million	0.5%
Youth Employment Initiative	72 million	0.1%
Total	15.32 billion	100.0%

Source: EC 2016

The European Commission has at many occasion stated that an enduring problem of Slovakia has been the slow absorption of EU funds. This has been the reason why drawing of EU funds from the 2007–2013 period has been prolonged until the end of 2015. This, however, has caused further delays in drawing funds from the 2014–2020 period due to staff being busy with managing projects from the foregoing period rather than concentrating on new projects. By the beginning of 2017, only 4% of the available funds (except the CAP funds) have been absorbed. (SME Ekonomika 2017)

The Socioeconomic Effects of Integration

Answering the question to what degree has integration affected Slovak migration is difficult due to the lack of truly reliable data. According to official population data as published by Eurostat, Slovakia is not as much affected by emigration as most other CEE countries (Figure 17). The number of people having legal residence in Slovakia has risen since 1989 by more than 3%, or more precisely from 5.26 million to 5.44 million.

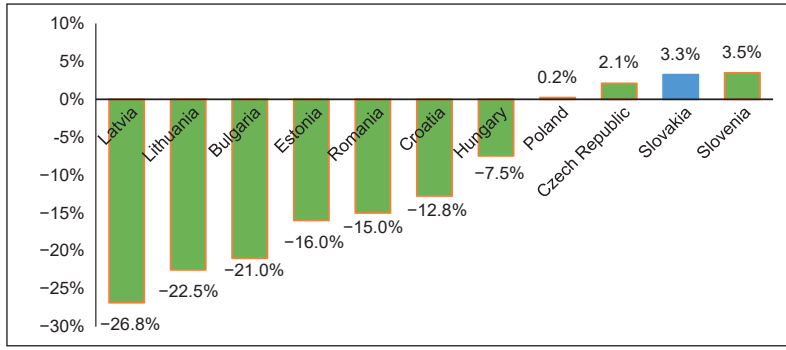


Figure 17.

Population change in eastern members of the EU between 1989 and 2017

Source: Eurostat 2017a

However, the reliability of these numbers may be questioned because they rely on official legal residence, which Slovaks have a habit of not changing even after having permanently moved to a different location. Using other, more sophisticated methods, indicates that emigration of skilled people from Slovakia, especially university students and graduates, is a serious problem. The Institute of Financial Policy at the Slovak Ministry of Finance has concluded that around 12–14% of university graduates leave the country every year after finishing studies. This mostly concerns graduates of medicine and engineering studies. (IFP s. a.b) The IFP also published a report which said that data from health insurance companies indicates a reduction of Slovakia's population, which questions official population data. According to this report, the number of persons who have health insurance in Slovakia has decreased by 300,000 over the years 2000–2015, which may indicate an effective decrease of overall population that may not be accounted for in the official census. (IFP s. a.b) The Statistical Office of the Slovak Republic has estimated the number of Slovaks working abroad short-term at 150,000, but the real number of people working abroad is estimated to be much higher, at around 300,000. (Denník Postoj 2017) The number of Slovak university students abroad is estimated at more than 36,000, which amounts to 16% of the 221,000 students studying in Slovakia. (Petková 2017) An important factor in the flow of students abroad is the lack of a language barrier between the Czech Republic and Slovakia, and the availability of tuition-free, higher quality university studies in the Czech Republic. The Czech Republic is the preferred destination of Slovaks who wish to study abroad. Currently there are more than 20,000 Slovak students at Czech Universities.

Conclusion and Outlook: Drawing the Balance of the Results of Integration

After a quarter century since gaining independence in 1993, we can conclude that the integration of Slovakia into the European and international economy was a largely successful story. Slovakia has managed to attract sufficient foreign investment, achieve strong economic growth, reduce unemployment, and raise the standards of living of its people. GDP per capita expressed

as a percentage of the EU average is approaching 80%. The gross nominal average wage has risen between 1993 and 2017 by a factor of 5.3 from 178 euros per month (using the official conversion rate of 30.126 SKK/EUR) to 944 euros per month. (STATdat. s. a.) Unemployment, reaching almost 20% at the turn of the century, has been reduced to below 8% at the start of 2018, with latest forecasts indicating a further downward trend towards 6% in the year 2020. Slovakia is also the only Visegrád country which has adopted the euro.

Still, certain key problems remain to be solved. The economic model employed by Slovak government cabinets since 1998 has also shown the limits to what can be achieved by concentrating on FDI-fuelled growth. For one, the dependence of the Slovak economy on exports is extremely high with 96% of GDP, which is much higher than what similarly-sized countries in the west experience (i.e. Denmark and Finland). Despite the 80% of employment being provided by SMEs, large foreign companies have been the dominant force driving economic growth. The international investment position of the Slovak Republic is markedly negative, with only negligible influence of Slovak capital abroad. The Slovak economy today is characterised by a high degree of dependence on foreign money, technologies and know-how (irrespective whether the funding comes from FDI or EU structural funds), for growth and investment. The attractiveness of Slovakia for foreign investment is still largely dependent on the price of labour. Despite labour productivity per person in purchasing power reaching 81% of the European average, nominal wages are just a third of the western European level. This highlights the need for a wage and price convergence in addition to convergence in economic output and productivity. An obvious obstacle towards achieving full convergence with "old Europe" is the poor performance of Slovakia in matters of higher education, science and innovation. Slovakia trails even most of its CEE peers, when it comes to the R&D intensity of its economy (Figure 18).

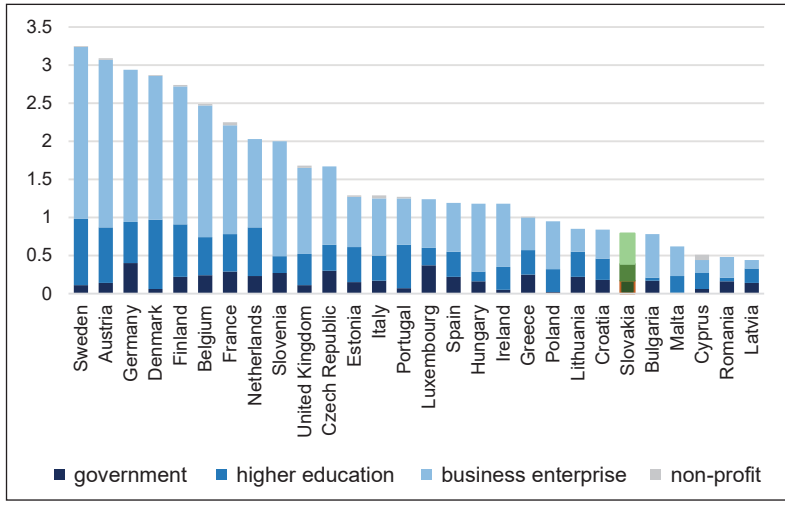


Figure 18.

Research and development expenditure by sector in 2016 (% of GDP)

Source: Eurostat 2017b

Yet the largest threat to sustainable economic growth of the Slovak economy lies in demographics. At present, Slovakia has one of the youngest populations in the European Union. The median age is around 40 years, which is one of the lowest in the EU. The old-age dependency ratio, expressing the ratio of people aged 65 or more relative to the active population and currently at around 20%, is also among the lowest in the European Union. However, if current levels of fertility and migration persist, by 2080 the median age in Slovakia could climb up to 54 years, which by then would be the highest value in the entire European Union. The old-age dependency ratio could climb up to 56%, and the total population could decline from currently 5.4 million to a something between 3.8 million and 4.8 million, depending on the scenario. (Eurostat 2018c) The reason for this lies not as much in emigration as in natural population development; Slovakia has a young population resulting from a baby boom in the 1970s and 1980s, but the current fertility rate of 1.4 is quite low. (Eurostat 2017c) Countering the negative demographic scenarios with a more open, inclusive immigration policy, as well as a more modern family policy enhancing fertility, is not an option but a necessity. Experience from western European countries shows that this is

possible (for instance, by providing better childcare options for families), but will require political leadership and communication to counter ingrained xenophobic tendencies and outdated attitudes towards the role of women.

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The volume reviews the processes and results of economic integration as well as patterns of interdependence in case of seven Central and Eastern European countries between 1989 and 2016. It presents country-specific experiences resulted from economic integration and interdependence. Based on these experiences, this comparative volume tries to identify the similarities and differences in paths followed by these countries and their impact on economic convergence. 13% of Europe's population live in these seven countries and this group contributes with 7.8% to the nominal GDP produced a year in Europe. All country-specific reports of the volume analyse the economic transformation process of the examined countries focusing on integration and interdependence in relation to other European countries. The reports that are based on literature review and the analysis of statistical data, expound the main macroeconomic indicators and trends of the countries in order to provide a comprehensive picture.

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