

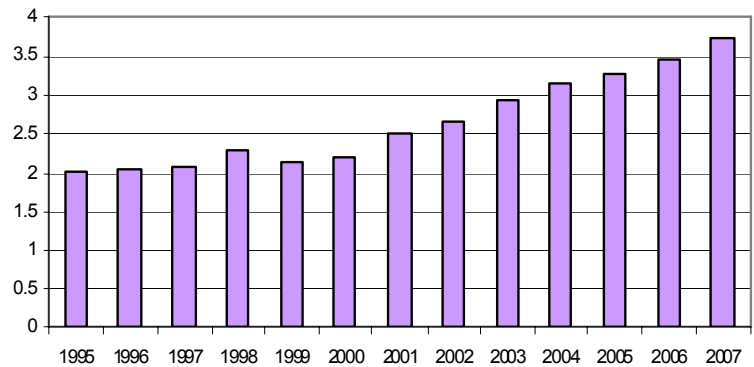


EU10 October 2008

In Focus: Trade Dynamics and Patterns in the EU10

The EU10 have integrated remarkably well into the global marketplace since the start of transition, and particularly in the last decade. While their share in global trade was largely constant in the late 1990s, the share increased from about 2 percent in 2000 to over 3.6 percent in 2007, a period of strong expansion in global trade (Figure 23). EU accession, markets liberalization, improvements in regulation and governance, investments in infrastructure, and the low cost of skilled and unskilled labor represent the combination of factors that explain this outstanding performance. Large inflows of foreign direct investment (FDI) have underpinned the surge in capacity and helped enhance the competitiveness of the region. Growth in exports and imports is weakening during the ongoing turmoil in international financial markets and slowdown in global economic expansion, but should resume at a more buoyant pace once the threat is dealt with.

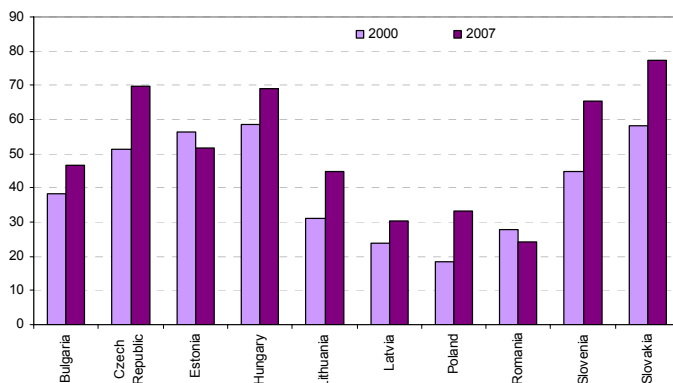
Figure 23. Share of the EU10 in World Trade, 1995-2007



Source: Eurostat, World Bank staff calculations.

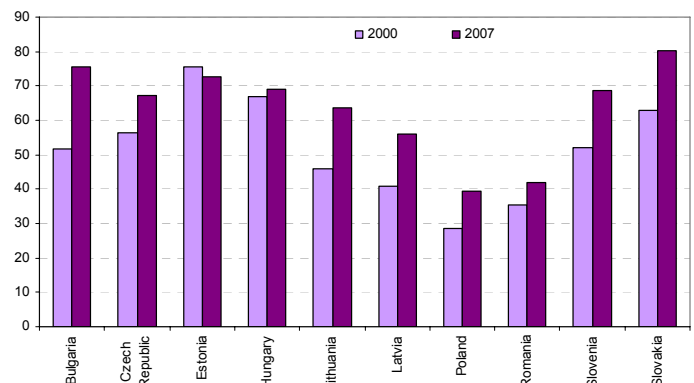
Within the EU10, the degree of trade openness continues to vary substantially across countries, with the early reformers having integrated more effectively into the global commerce. Hungary, the Czech Republic and Slovenia, but also Slovakia, have seen exports rise to about or more than 70 percent of GDP (Figure 24 and Figure 25). There seems to be no obvious correlation between the size of the economy and the level of trade flows. Both large countries (such as Poland and Romania) and small ones (such as Latvia and Lithuania), have low, though expanding, trade shares in GDP. Growth in exports has largely kept up with growth in imports in recent years, but trade deficits have gradually widened in Bulgaria and Romania, reflecting a combination of surging imports of investment and consumer goods.

Figure 24. Exports to GDP, 2000 and 2007 (in percent)



Source: Eurostat, World Bank staff calculations

Figure 25. Imports to GDP, 2000 and 2007 (in percent)

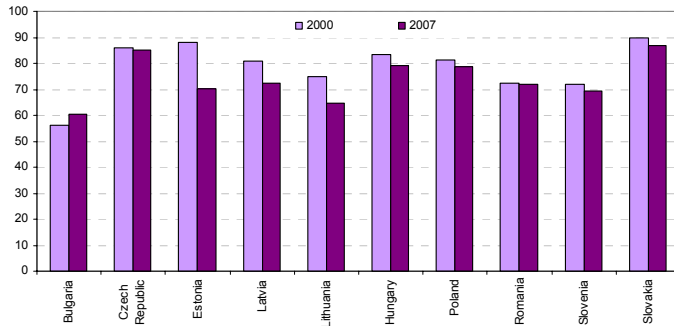


Source: Eurostat, World Bank staff calculations

The process of trade integration into the EU has substantially deepened throughout the region and the share of commerce with Western Europe is already comparable to that of the intra-EU15 trade (Figure 26 and Figure 27). The process of EU accession has played a key role in the reorientation and growth of the EU10

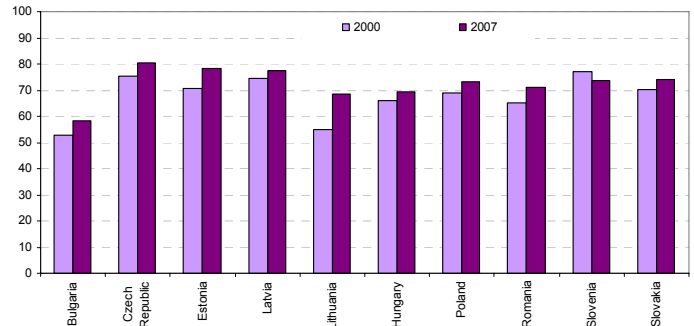
trade, with the expansion firmly anchored into the EU production and distribution chains. The gradual removal of trade barriers with the EU15 and among the EU10, together with important advances in addressing structural challenges, have considerably improved the attractiveness of EU10 as destination for global investment. The region has become a target for the relocation of companies in search of cost reductions mainly in production, but also in innovation.

Figure 26. Exports to the EU Relative to Total Exports, 2000 and 2007 (in percent)



Source: Eurostat, World Bank staff calculations

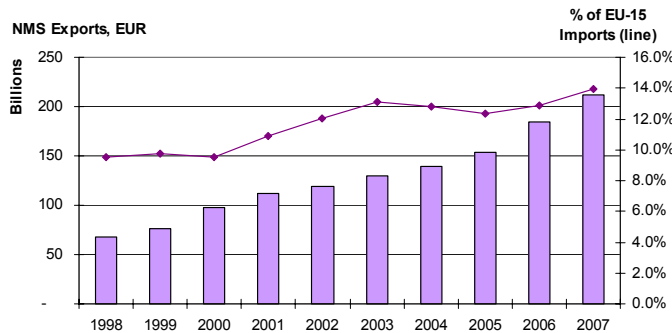
Figure 27. Imports from the EU Relative to Total Imports, 2000 and 2007, (in percent)



Source: Eurostat, World Bank staff calculations

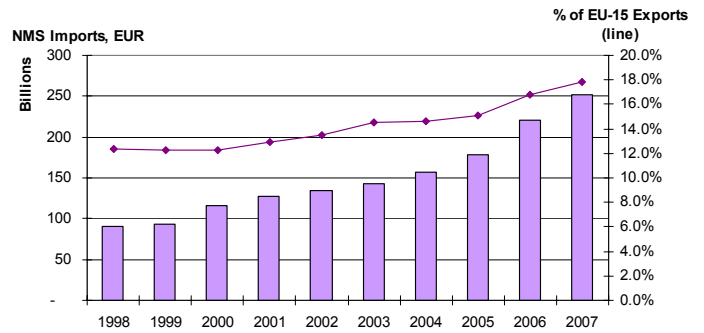
The EU10 have become a noteworthy partner of EU15 in terms of trade volumes. Exports from the EU10 to the EU15 have constantly increased this decade, tripling from about €70 billion in 2000 to more than €200 billion in 2007; the latter is equivalent to 14 percent of total EU15 imports (Figure 28). Similarly, exports from the EU15 to the EU10 currently exceed €250 billion, or 18 percent of total EU15 exports (Figure 29). The trade balance remains though tilted towards EU15, which record a yearly surplus of close to €50 billion.

Figure 28. Exports from the EU10 to the EU15



Source: Eurostat, World Bank staff calculations

Figure 29. Imports from the EU10 to the EU15

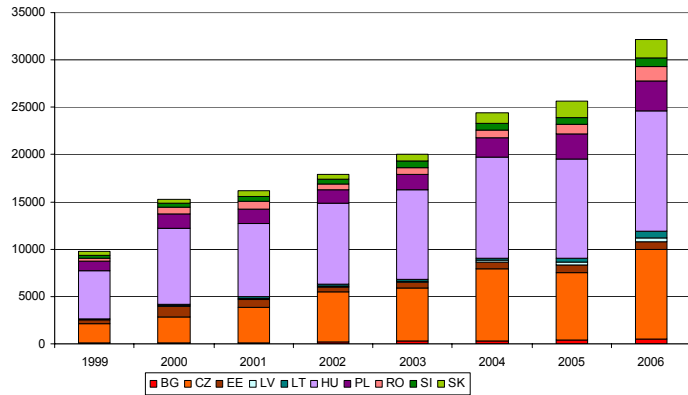


Source: Eurostat, World Bank staff calculations

The volume of high technological exports from the EU10 to the EU15 has increased threefold since 1999, but its share in total EU10 exports does not appear to have gone up visibly. Hungary and the Czech Republic account for the largest share of high tech exports, although Poland and Slovakia are gradually picking up. Evidence suggests that, as labor costs increase, countries steadily move up the value added chain, but lower tech exports still record important expansions (Figure 30 and Figure 31). This is explainable by the fact that unit labor costs in the EU10 remain well below those in the EU15, and countries in the region appear to remain competitive in labor-intensive areas.

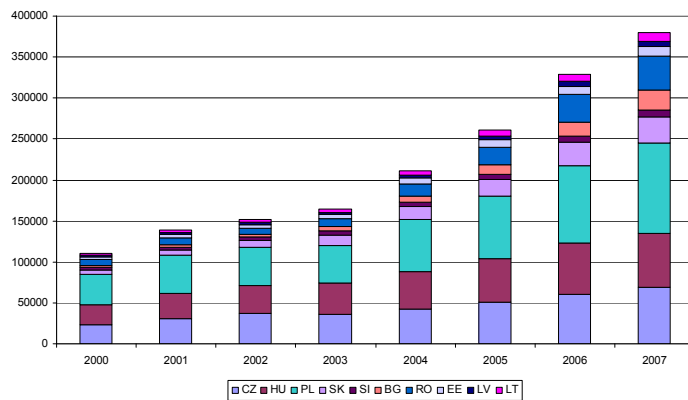
Large inflows of FDI and the accompanying import of technological and management know-how, are key contributor to the remarkable export performance. Cumulative FDI inflows to the region have increased threefold since 2000, exceeding €350 billion at the end of 2007 (Figure 32-Figure 34). Hungary, Poland and the Czech Republic have historically been the main beneficiaries, but Slovakia, Romania and Bulgaria have registered record inflows in recent years. Evidence indicates a positive correlation between FDI inflows into manufacturing and the substantial advancements in gross value added in the sector, with positive impact on exports. Imports of machinery and equipment account for a large share of total imports (larger than 30 percent in all countries, exceeding 50 percent in Hungary).

Figure 30. EU10 High Tech Exports, 1999-2006 (in millions of euros)



Source: Eurostat, World Bank staff calculations

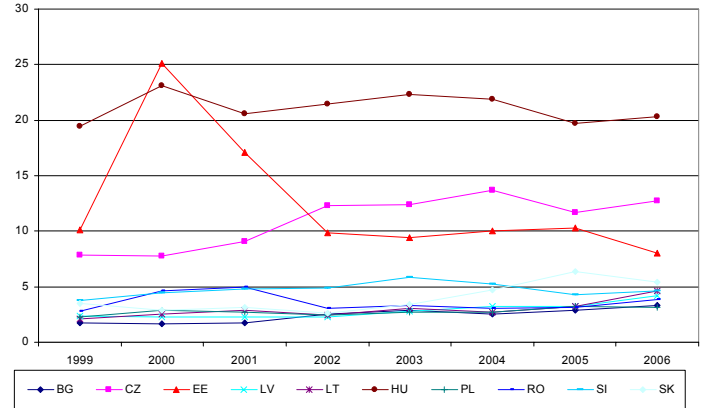
Figure 32. Inward FDI Stock in the EU10, 2000-2007 (in millions of euros)



Source: Eurostat, World Bank staff calculations

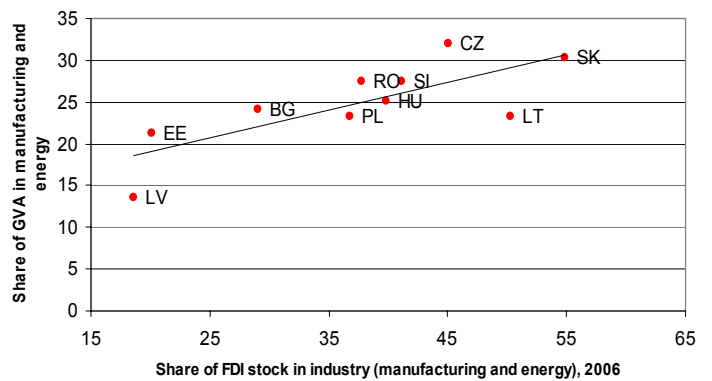
Conversely, deeper integration and alignment in trade composition with the EU15 also leave EU10 more exposed protracted to slowdown in the West European markets. The increased correlation of business cycles and the higher share of intra-industry trade could, *ceteris paribus*, have adverse implications for growth in EU10 output and exports. In the early 2000s, for example, the impressive pick up in EU10 exports to the EU was associated with a notable reorientation of the Western consumers substituting locally produced labor intensive commodities with cheaper ones from the EU10, in the context of the prolonged slowdown in the EU15. This might no longer be the case in the current economic context, pointing once more to the need of pursuing further productivity and competitiveness enhancing measures in the new EU members.

Figure 31. Share of High Tech in Total Exports by Country, 1999-2006 (in percent)



Source: Eurostat, World Bank staff calculations

Figure 33. FDI in industry as % of total FDI and GVA in manufacturing and energy as % of total GVA



Source: Eurostat, World Bank staff calculations

Figure 34. Share of machinery in total EU10 imports, 2000, 2007, (in percent)



Source: Eurostat, World Bank staff calculations