

*Growth Prospects in Central Europe
after EU Enlargement*

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CEE4 economies have performed well since mid-1990s

- Strong growth of real GDP (4% p.a.)
- Low inflation
- Transition towards market-based economy
- Integration into international trade and capital flows

Table 1. Various convergence speeds

	GDP per capita at 1995 prices and PPPs (\$) ^a		1995-2003 annual growth	
	1995	2003	Real GDP	Real per capita GDP ^a
Ireland	17 885	29 984	7.9	6.7
Poland	7 529	10 460	4.0	4.2
Hungary	9 022	12 389	3.8	4.0
Slovak Republic	8 109	10 933	3.8	3.8
Korea	11 451	15 387	4.5	3.8
Greece	12 983	16 791	3.7	3.3
Spain	15 750	19 652	3.3	2.8
Mexico	6 932	8 165	3.6	2.1
Portugal	13 159	15 445	2.5	2.0
OECD	19 962	23 254	2.7	1.9
Czech Republic	12 016	13 971	1.8	1.9
European Union	19 931	23 066	2.1	1.8
New Zealand	17 018	19 692	3.0	1.8
Turkey	5 480	6 066	3.2	1.3

a) GDP per capita data based on OECD Annual National Accounts. Where unavailable, data for 2003 are estimated based on OECD *Economic Outlook No. 75* growth rates.

Source: OECD.

Hope that entry to EU will lock in progress

- Remaining trade restrictions removed
(but labour mobility not allowed)
- Access to EU “structural funds”
(but new budgetary spending strictly capped)
- In due time, entry to euro area
(but budget deficits & ERM narrow bands cause concerns)
- Expect to repeat economic success of previous entrants
(like Ireland and Spain rather than Portugal and Greece).

However fast convergence will not happen automatically

- Incomes levels are low compared to EU15
(from 45% in Poland to 61% in Czech R. at PPP rate)
- Even though growth is fast, it is not fast enough
(at current speed, it will take 30 to 40 years to bridge half of gap)
- Some features of central planning system not removed
(social protection, government intervention, labour income taxation)
- How could income convergence be enhanced?

Job-friendly policies could increase labour utilisation

- Productivity growth has been strong
(thanks to restructuring, FDI, technology spillovers)
- But income convergence needs both productivity and jobs
 $GDP/POP = GDP/EMP * EMP/POP$
- Labour utilisation hindered by various restrictions
 - High labour income taxes
 - Employment protection legislation
 - High minimum wages compared to average wages
 - Low regional labour mobility
 - Growth rebound an opportunity to reform labour market

Figure 1. Sources of growth in selected OECD catching-up countries
1995-2003

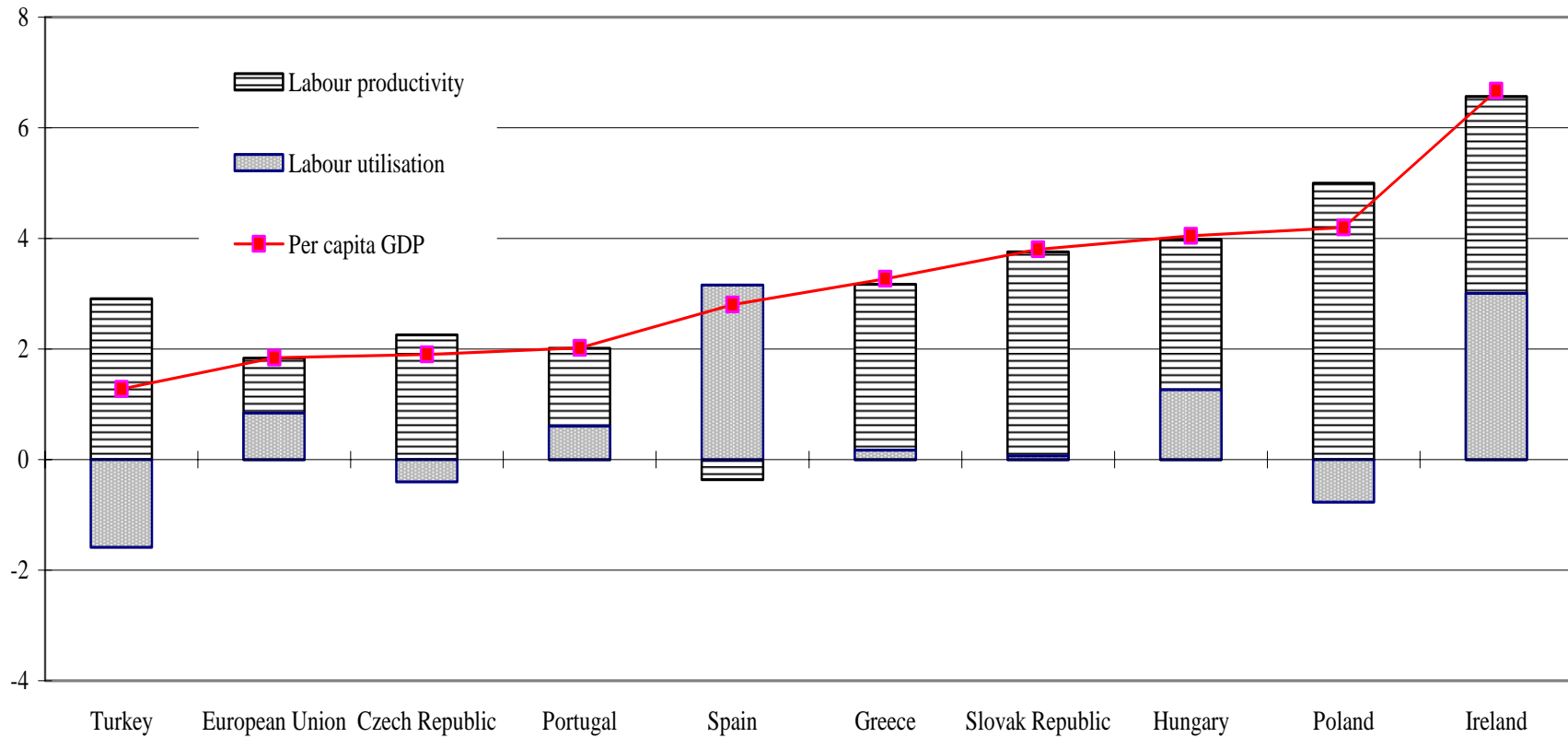
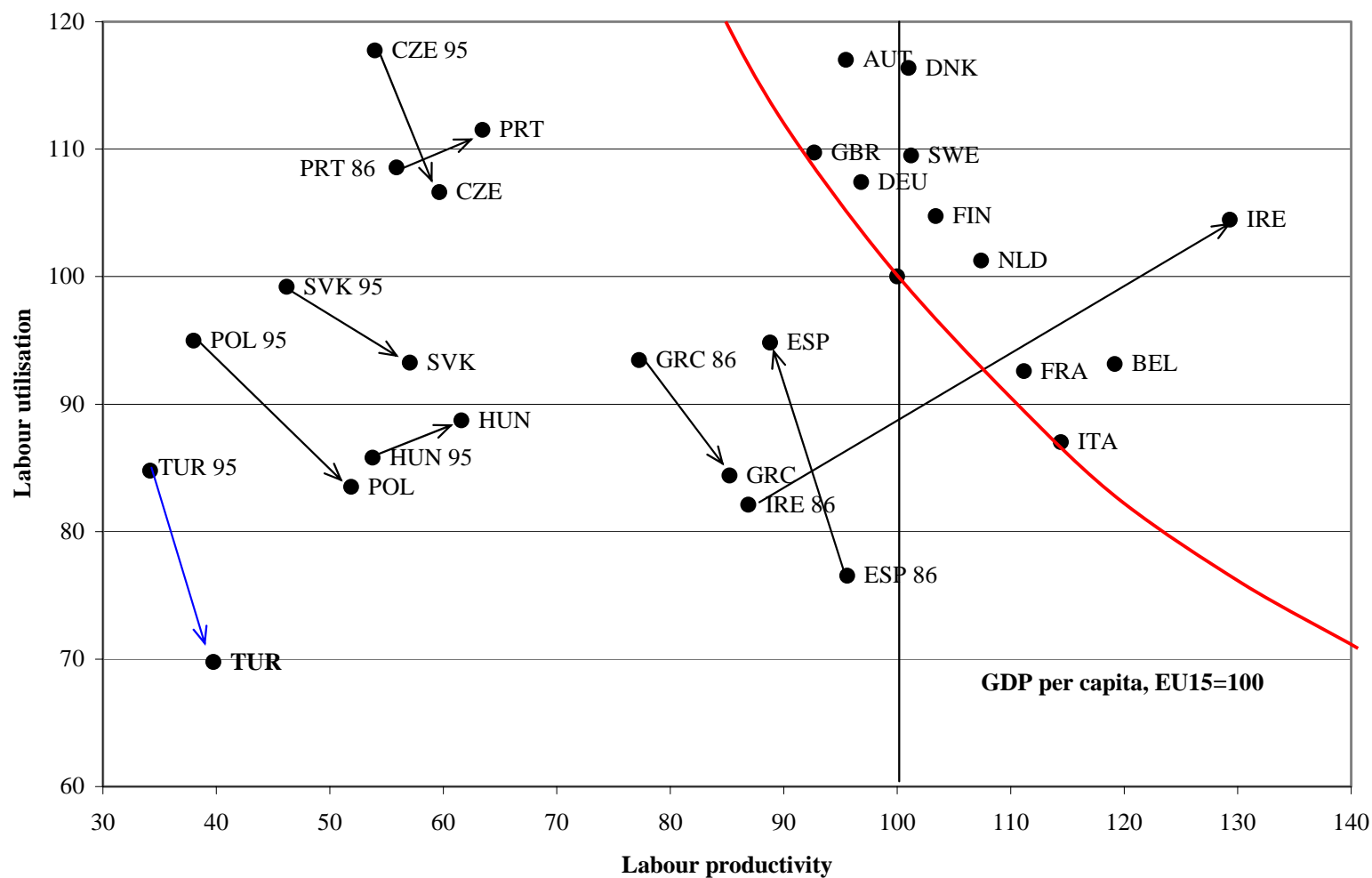


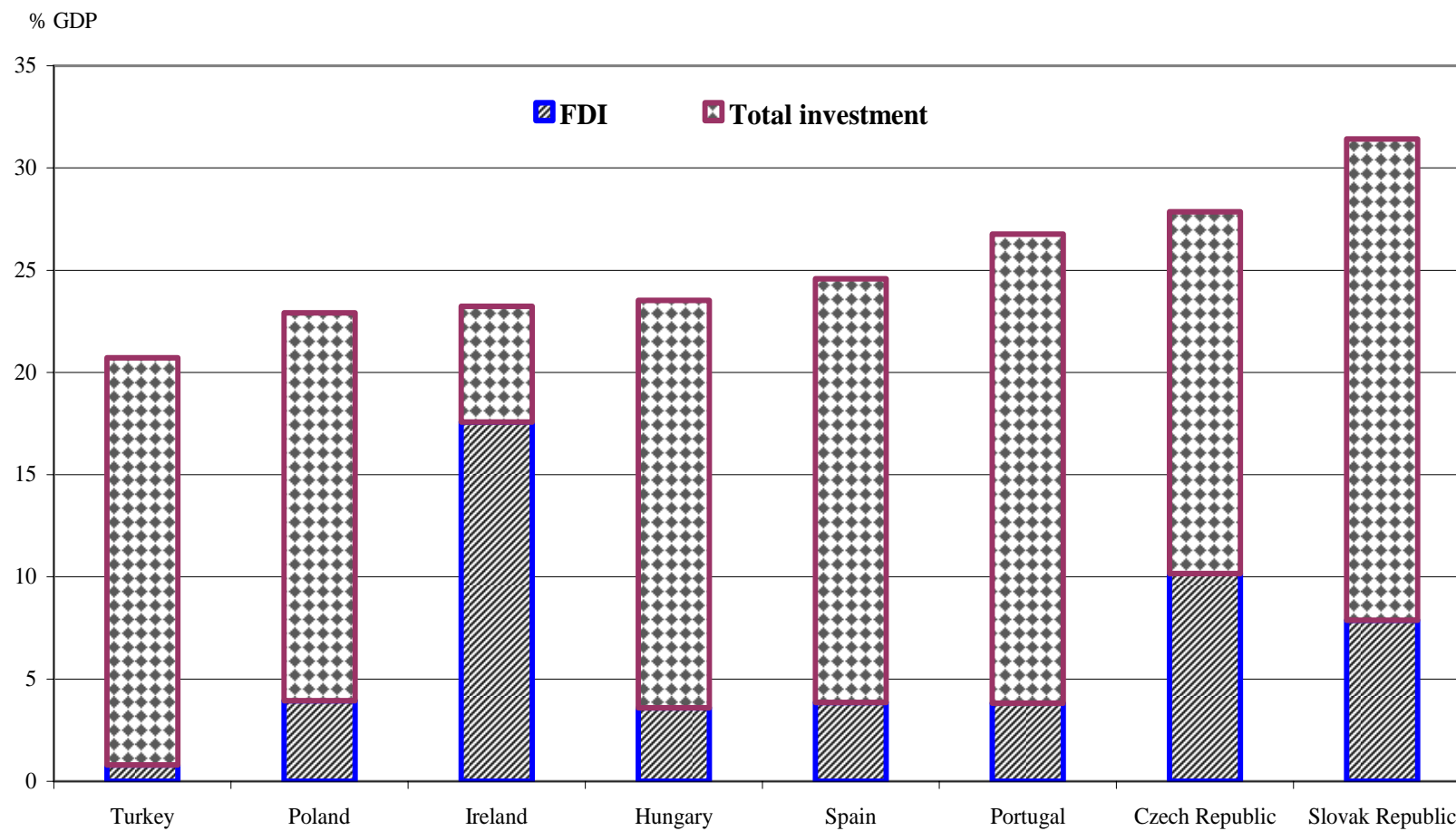
Figure 2. GDP per capita -- Various convergence patterns, 2003
(EU15=100)



More FDI needed to boost capital formation

- After initial FDI boom, inflows have tapered off
Foreign investment in anticipation of enlargement
- Competition with other countries to attract FDI
China & Russia increasingly attractive according to recent surveys
- A second wave of FDI is possible
Investments in services (air shipments, firm accounting, etc.)
- Actions taken (lower CIT) but more needs to be done
Level the playing field in competition policy
- Improve infrastructure, especially transportation network

Figure 3. FDI inflows and total investment, average over the period 1998-2002



Source: OECD; Unctad.

Growth will come from knowledge economy in the medium term

- Strong productivity will require continued process innovation
(Efficiency of workers increased by embedding ICT)
- Technology spillovers benefit catching-up countries
(Exposure to trade and investment helps to reap gains from foreign innovation)
- But technology does not reach local producers automatically.
- Product market competition encourage to innovate
- R&D spending important to monitor / understand / import innovation
- Secondary and tertiary education matter, but not traditional education model

IN SUM

- Accession to the EU does not guarantee automatic convergence
- Central Europe inauspicious to job creation
- Labour market reform needed to boost growth
- A second wave of FDI inflows is possible
- But it needs to level playing field and upgrade infrastructure
- In medium-term, growth will come from knowledge economy
- To reap benefits from spillovers: more competition, R&D and education

Thank you for your attention.

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- For more information:

- www.oecd.org/eco/economic_outlook