**Erste Group Research**
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# Visegrad Four - 10 years of EU membership

V4 countries are economically stronger and more relevant 10 years after EU accession. Their annual average GDP growth has increased by approx. 1% due to EU membership. V4 exports have grown three times faster than EU15 exports; the V4 is now the fourth largest exporter in the EU28.

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**During 10 years of EU membership, the Visegrad Four - V4[1] countries have experienced strong income convergence. The GDP per capita of the V4 measured in purchasing power standards has increased from 49% of that of the EU15 in 2003 to 65% in 2013. Three out of four V4 countries (SK, PL, CZ) jumped in the quality of life ranking, with Czech Republic actually surpassing Italy and the UK. Based on benchmarking of the average growth of the V4 countries to some European countries at their earlier stage of income convergence, we estimate that EU membership increased the annual average growth in the V4 by around 1pp in the last decade.**

**EU membership has expanded the export opportunities of V4 countries, of which three (CZ, HU, SK) are among the top 5 open economies in the EU28. V4 countries have been outperforming the old member states in export growth by a wide margin: their exports grew three times faster than exports of old EU member states in the last decade. The V4 region now ranks as the fourth largest exporter in the EU28 (compared to the sixth position in 2003), becoming a real heavyweight among European exporters. Car manufacturing became the most prominent export-oriented industry in the V4. While around a decade ago, the V4 countries were producing fewer cars than France, Spain, the UK and Italy, the V4 is now the second largest car producer in the EU after Germany.**

**Old EU member states also benefited from the EU enlargement. With a population of 64mn, the V4 offers a similar size consumer market in terms of the number of consumers to France or Italy and, in terms of the value of consumer spending on goods, to the Benelux (EUR 230bn) countries. Exports from old member states to the V4 have skyrocketed, growing twice as fast as their total exports.**

**In order to maintain the income convergence and utilize further benefits from EU membership, the V4 countries need to move up the value chain of production, explore more possibilities in the export of services and improve the quality of institutions, which would help them to raise their absorption of EU funds. In the future, all V4 countries will experience demographic aging. As a result, there will be fewer people entering the labor market. Unless V4 countries are prepared to undertake significant efforts to attract skilled labor from abroad in the medium term, it is foreseeable that work force shortages will hurt potential GDP growth significantly throughout the region.**

*This report was created with the help of Zoltan Arokszallasi, Zoltan Bakay and Katarzyna Rzentarzewska*

[1] The Visegrad Group, also called the Visegrad Four or V4 is an alliance of four Central European states – Czech Republic, Hungary, Poland and Slovakia.

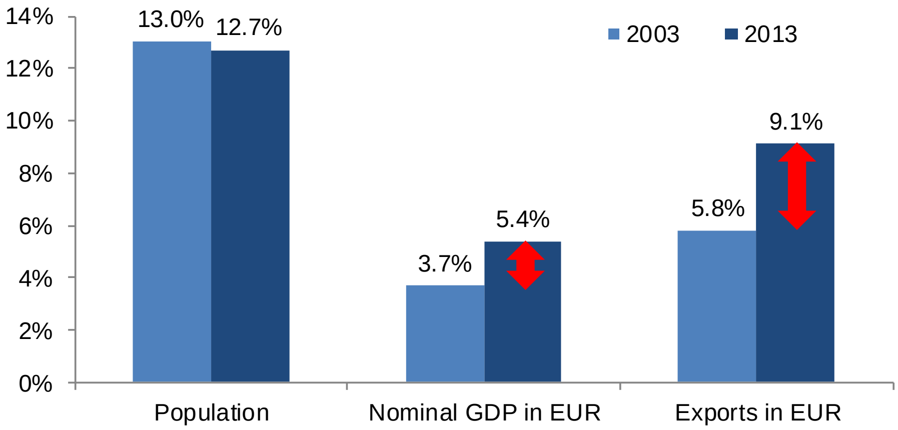
**Juraj Kotian**
Head of CEE Macro/Fixed Income Research

# Economic impact of EU membership on Visegrad countries

**Population of V4 amounts to 13% of EU28, but its nominal GDP was only 3.7% of EU28 one decade ago**

The V4 countries joined the EU in 2004 as rather weak nations economically, but with huge growth potential. With a population of above 64mn, or 13% of the EU28, the economic output of the Visegrad countries totaled only about 3.7% of that of the EU28. After 10 years of EU membership, the V4 countries have become much stronger economically and more relevant for the European Union. The economic strength of the V4 relative to the EU28 as measured by GDP has increased by one half over the last decade to 5.4% of that of the EU28. The economic relevance of the V4 has become most visible in foreign trade. The share of V4 exports relative to those of the EU28 has increased to 9.1%, from 5.8% a decade ago.

**Economic importance of V4 has increased over last decade (V4 as % of EU28)**

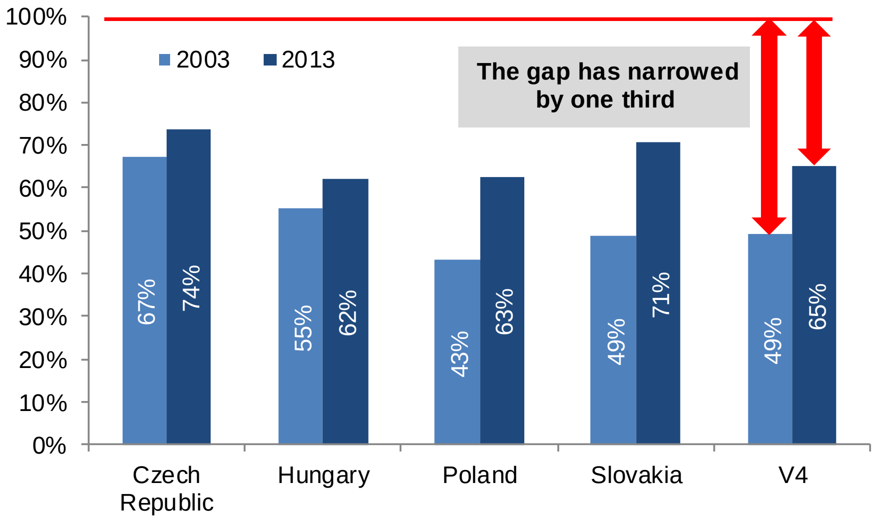



*Source: Eurostat, Erste Group Research*

**Income gap between V4 and the old EU members has narrowed by 1/3**

Over the last decade, the V4 countries have experienced strong income convergence. The GDP per capita of the V4 measured in purchasing power standards has increase from 49% of that of the EU15 in 2003 to 65% in 2013. Thus, the income gap between the V4 and the old EU members has narrowed by 1/3. In line with income convergence theory, countries with a lower initial level, like Slovakia and Poland, were growing much faster than the more advanced Czech Republic. Hungary was unfortunately a little bit of an outlier in income convergence, mostly due to domestic policy mistakes. The twin deficit in 2003-06 and unorthodox measures have undermined the growth potential of Hungary and it has been surpassed by Poland and Slovakia in income convergence.

**GDP per capita in purchasing power standards (% of EU15)**




*Source: Eurostat, Erste Group Research*

**Three out of four V4 countries jumped in quality of life ranking, with Czech Republic actually surpassing Italy and UK**

The progress has gone far beyond just headline indicators like increase in GDP per capita. Three out of four V4 countries jumped in the quality of life ranking, with Czech Republic actually surpassing Italy and the UK. That is an index built from average ranking of countries in 10 indicators that might according to Eurostat[2] have a material effect on quality of life (like life expectancy, early school leavers, income inequality, gender pay gap, homicide rate, etc.). Slovakia, the Czech Republic and Poland were among the top five countries with the largest improvement in scoring over the last decade, while Hungary experienced the second largest worsening right after Greece.

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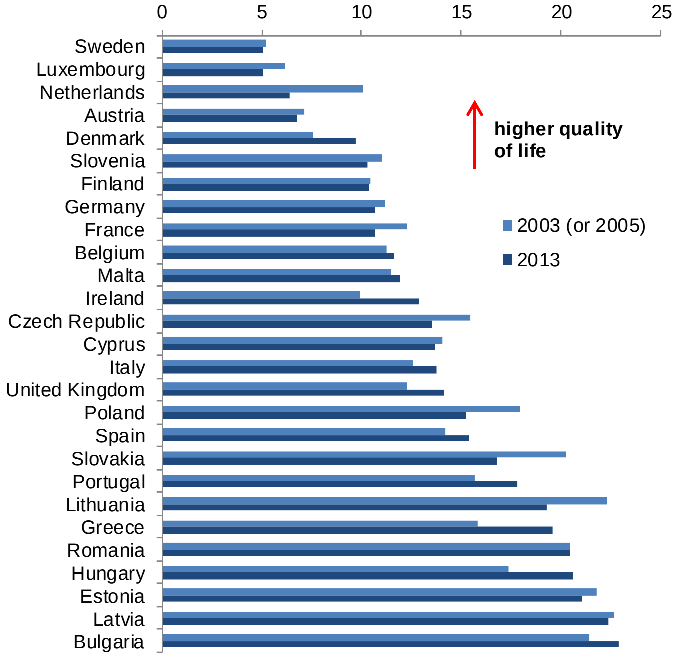
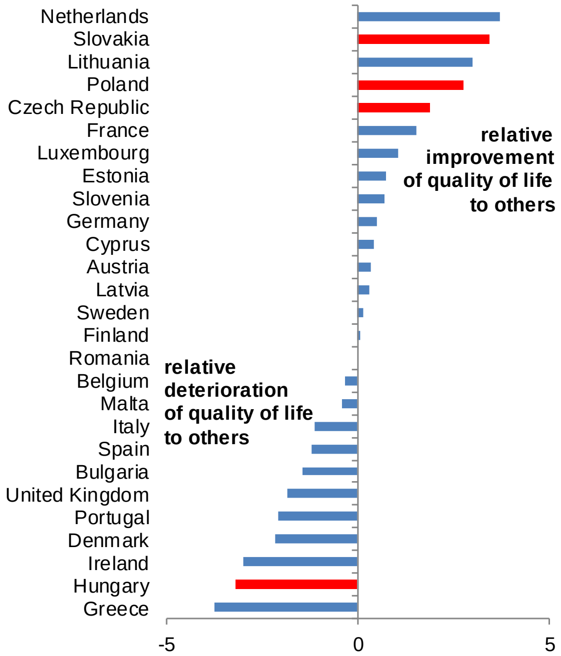
[2] 'Quality of life' indicators were originally released by Eurostat for 2012, on 19 March 2013. (http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/3-19032014-CP/EN/3-19032014-CP-EN.PDF). We constructed the overall index based on average ranking in all categories. Due to availability of data, however, we needed to omit the air pollution variable (PM 10), change the homicide rate definition slightly, use years of 2003-2006 (In the case of Romania, for the median income and for the ability to afford unexpected expenses, we used 2007 as reference year).

**Quality of life index**




*Source: Eurostat, Erste Group Research*

**Changes in index (2013 vs. 2003)**




*Source: Eurostat, Erste Group Research*

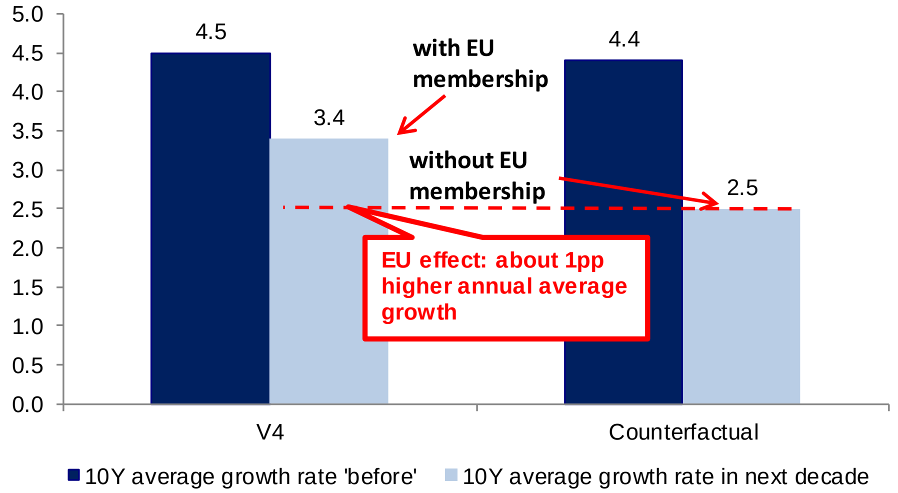
**EU membership increased annual average growth in V4 by around 1pp**

EU membership obviously has an overall positive impact on the development and wealth of V4 economies. But it is difficult to precisely measure the size of these effects. In order to estimate the impact of EU membership on economic growth[3] in the V4, we built a simple counterfactual from the European countries that had experienced similar growth in one decade like the V4 did in 1993-2003 (we took Austria 1965-75, Norway 1969-79, Portugal 1967-77 and Spain 1967-77[4]), but were not EU members for another decade. Afterwards, we compared the growth differential, which would give us a rough estimate of how the income convergence in the V4 would have naturally slowed down if the V4 countries had not gotten a boost from EU membership. Based on benchmarking of the average growth of the V4 countries to some European countries at their earlier stage of income convergence, we estimate that EU membership increased the annual average growth in the V4 by around 1pp in the last decade.

[3] Different studies determine the positive impact from European integration to range from five percent (Boltho and Eichengreen, 2008) to as much as 20 percent (Badinger, 2005) when comparing actual GDP per capita with hypothetical GDP. A recent study by Campos, Coricelli and Moretti (2014) presents a comparison between real and synthetic GDP development (using the synthetic counterfactuals method), suggesting that the gain from EU membership is at least 12% of GDP. Moreover, they stress that, in the case of V4, the "anticipation effects" might have been particularly strong, meaning that the prospect of EU membership was already a strong enough impulse to begin generating benefits for these countries. Such a broad range in estimates of the effects on economic development is the result of one major obstacle – the lack of any counterfactual examples, which makes a "what if" analysis hard to conduct and casts doubt on any results obtained from such an analysis.

[4] In the case of Spain and Portugal, there was a slight overlap with EU membership, which makes the final estimate more conservative.

**Estimated impact of EU membership on average GDP growth in V4 (%)**

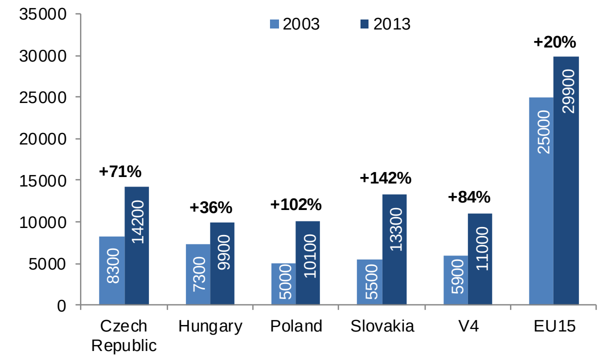



*Source: AMECO, Erste Group Research*

**GDP per capita in EUR outperformed old EU15; it more than doubled in Poland and Slovakia**

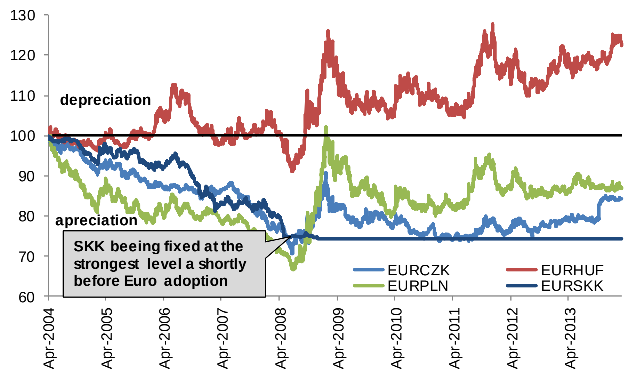
Income has also increased substantially in nominal terms. GDP per capita in EUR has more than doubled in Slovakia and Poland since EU membership. In the Czech Republic, the increase has been about 70%, but significantly lower in Hungary - only about 36%. However, this is still high enough to outperform the old EU15. The convergence in nominal terms has been strongly affected by exchange rate developments, where the depreciation of V4 currencies during the crisis slowed down or even reversed part of the nominal convergence.

**GDP per capita in EUR**




*Source: Eurostat, Erste Group Research*

**Exchange rate (Index, April 30, 2004=100)**

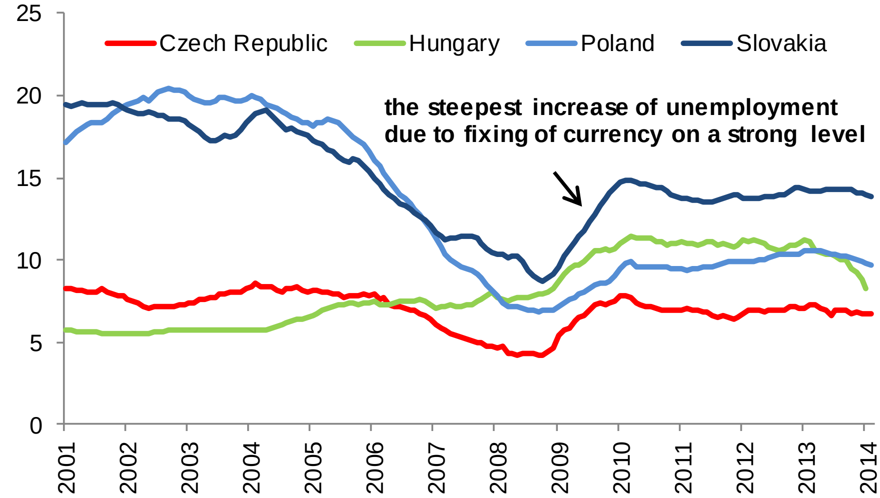



*Source: Bloomberg, Erste Group Research*

**Forint is only currency weaker than before EU entry (-22%), Slovak koruna gained most (+26%)**

Hungary is the only country where the currency is actually weaker (-22% against the euro) compared to the time of EU entry. The reasons for this are the high external imbalances at the beginning of EU membership and high accumulation of external debt. The Slovak currency gained the most among the V4 (26% until mid-2008), as it managed to join the euro, which prevented the currency from high fluctuations during the financial crisis. Even more, Slovakia managed to fix the conversion rate at its all-time high in 2008 at the upper boundary of fluctuation band.

**Unemployment rate (seasonally adjusted, %)**

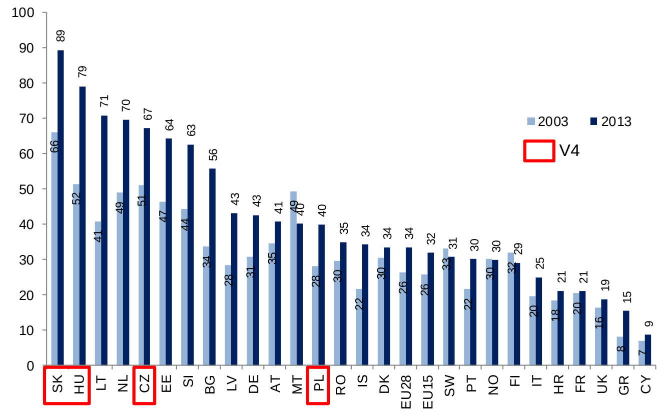



*Source: Eurostat, Erste Group Research*

**Strong conversion rate and rigidity of exchange rate spiked unemployment in Slovakia during crisis**

However, euro adoption came at some costs that were not so apparent before the onset of the financial crisis. Fixing the conversion rate at a strong level helped to tame inflation risks associated with euro adoption in Slovakia, but backfired when the crisis hit the region and the currency could not depreciate like other V4 currencies did. Slovakia lost about 10-15% in price competitiveness against V4 countries, due to its strong and rigid exchange rate. The labor market was the only shock absorber at that time and that is why unemployment spiked in Slovakia much more than in other V4 countries.

**Exports of goods as % of GDP**




*Source: Eurostat, Erste Group Research*

**Biggest exporters in EU28 (EUR bn)**

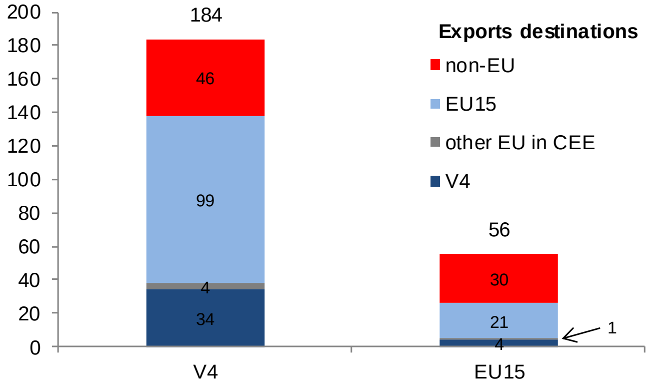
| 2003 | 2013 |
|---|---|
| DE (661) | DE (1169) |
| FR (323) | FR (434) |
| UK (271) | NL (420) |
| IT (263) | **V4 (398)** |
| NL (233) | IT (390) |
| **V4 (155)** | UK (359) |
| SW (92) | SW (129) |
| AT (78) | AT (128) |
| DK (57) | DK (83) |
| FI (46) | FI (56) |
| PT (31) | PT (49) |

*Source: Eurostat, Erste Group Research*

**V4 exports grew three times faster than exports of old member states**

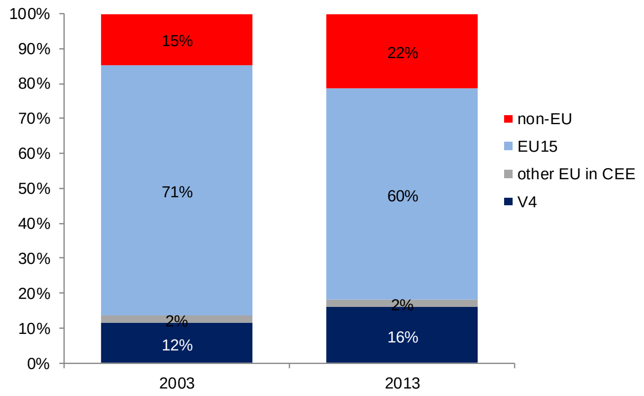
EU membership has expanded the export opportunities of V4 countries. This is one of the most important advantages for the region, as three out of four V4 countries (Slovakia, Hungary and the Czech Republic) rank in the top 5 most open economies in the EU. V4 countries were outperforming the old member states in export growth by a wide margin. Exports of V4 countries grew three times faster than exports of old EU15. The V4 region now ranks as the fourth largest exporter in the EU28 (compared to the sixth position in 2003), becoming a real heavyweight among European exporters.

**Contributions to export growth (2003-13, %)**




*Source: Eurostat, Erste Group Research*

**Geographical breakdown of V4 exports**

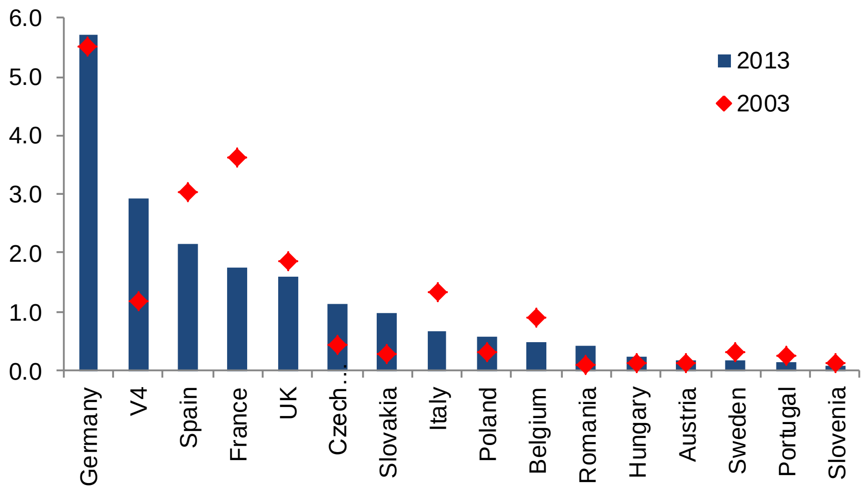



*Eurostat, Erste Group Research*

**V4 became second largest car producer in EU after Germany**

The highest contribution to export growth came from exports to old member states. However, V4 countries were also successful on external markets – their exports to non-EU28 countries have quadrupled since 2003. EU enlargement provided a unique opportunity for companies in Western Europe to build new or scale-up existing production capacities in the V4 that would make them more competitive both on the internal EU market and the external market as well. Car manufacturing became the most prominent export-oriented industry in the V4. V4 countries have been persistently outperforming car production in old member states and the V4 became the second largest car producer in EU right after Germany.

**Car production (mn)**

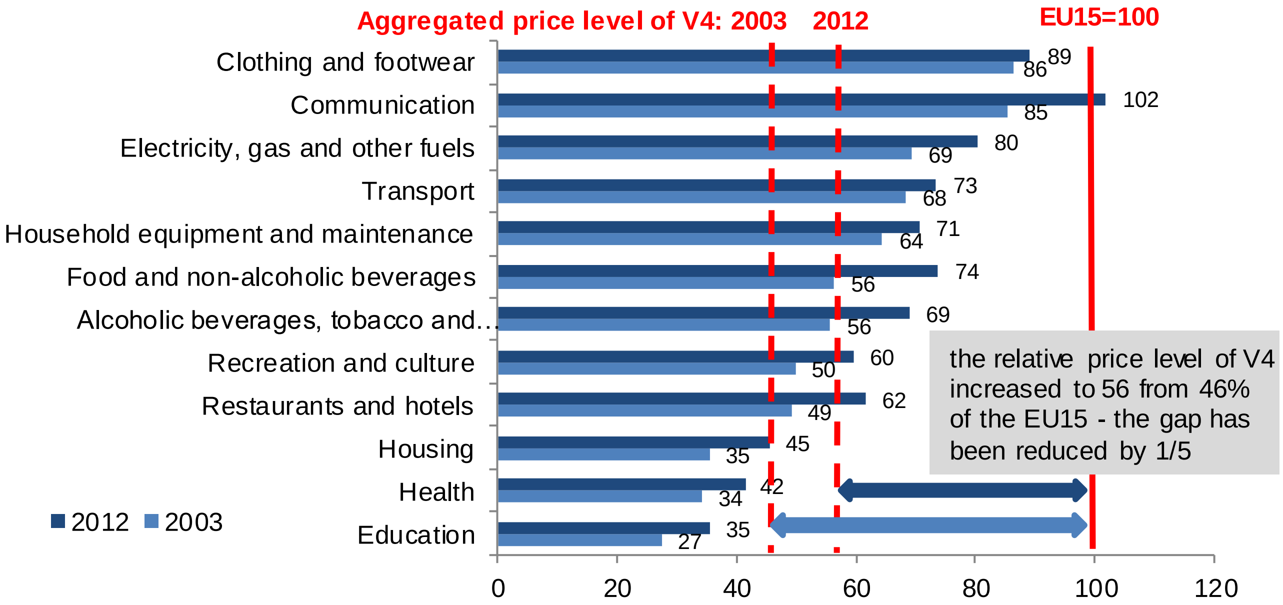



*Source: OICA, Erste Group Research*

**Highest price gap remains in state regulated services**

Price convergence had to proceed hand in hand with income convergence. The price level gap in tradable goods has always been relatively thin, while the highest potential for price convergence had been in services. The aggregated price level of the V4 had increased to 56% of that of the EU15 in 2012, from 46% in 2003. The price gap has narrowed by 1/5. The highest price gap still remains in state regulated services, like healthcare and education, due to the lack of liberalization of the market and the government's preference to provide many services for free or at low costs, albeit at the expense of quality.

**Average price level of V4 countries relative to EU15**

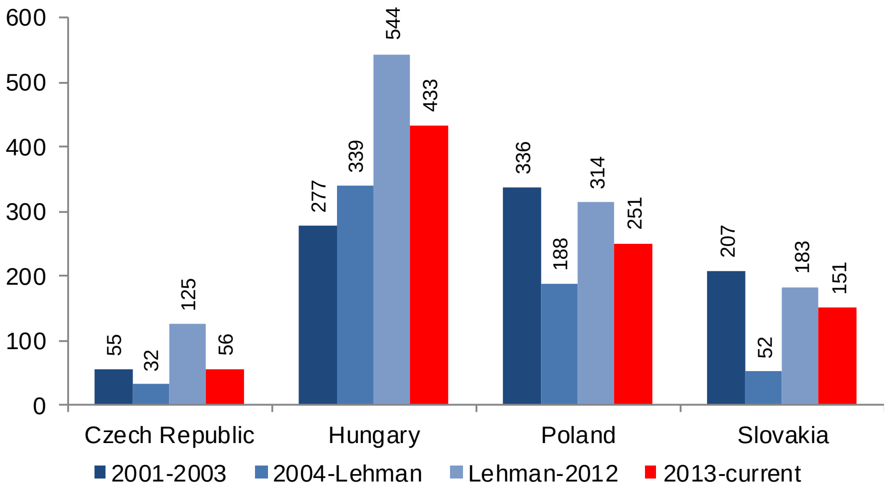



*Source: Erste Group Research*

**Spreads on long-term government bonds are today below pre-accession period (except for Hungary)**

EU membership has brought a reduction of the risk premium that V4 countries had to bear. Spreads on long-term government bonds yields collapsed shortly before EU membership and in the early years of membership. This was not the case for Hungary, which was struggling with a lack of fiscal discipline and rising imbalances. Spreads spiked during the financial crisis in all countries for a while, but they are now again below the level seen in the pre-accession period (except for Hungary).

**Average spread on long-term government yields vs. Germany (bp)**




*Source: Eurostat, Erste Group Research, Note: bonds issued on domestic market*

**Czech Republic, Poland and Slovakia belong among best rated countries in EU28; Hungary ranks at bottom**

Before the V4 countries became EU members, they occupied the lower end of the rating ranks of European economies. Slovakia was ranked 25th among the current 28 EU members based on its S&P long-term rating in January 2004. Since then, the Czech Republic, Poland and Slovakia have been among the few countries whose ratings have improved. They climbed 8-12 positions on the rating list and are now among the 14 best-rated countries in the EU28. Unfortunately, this was not the case for Hungary, which wasted its potential. Its large accumulation of public and external debt over the last decade, plus a wide range of unconventional measures (which undermine the future growth potential of the Hungarian economy) have led to a downgrade of Hungary by five notches. Hungary now belongs to the group of five countries sitting at the bottom of the rating list of EU28 members, according to S&P.

**Long-term sovereign rating by S&P**

| | Jan 2004 | Apr 2014 |
|---|---|---|
| AAA | 1-10 (AT,DK, FI, FR, IE, DE, NL, SW, LX, GB) | 1-6 (DK, FI, DE, SW, LX, GB) |
| AA+ | 11-12 (BE,ES) | 7-8 (NL, AT) |
| AA | 13-14 (IT,PT) | 9-10 (FR,BE) |
| AA- | | 11-12 (**CZ**,EE) |
| A+ | 15-16 (SI,GR) | |
| A | 17-18 (MT,CY) | 13 (**SK**) |
| A- | 19-21 (**CZ**,**HU**, EE) | 14-15 (**PL**, SI) |
| BBB+ | 22-24 (**PL**,LV, LT) | 16-18 (IE, LV, MT) |
| BBB | 25 (**SK**) | 19-21 (IT, BG, LT) |
| BBB- | 26 (HR) | 22 (ES) |
| BB+ | 27 (BG) | 23 (RO) |
| BB | 28 (RO) | 24-26 (**HU**,PT,HR) |
| BB- | | |
| B+ | | |
| B | | |
| B- | | 27-28 (CY,GR) |

*Source: Bloomberg, Erste Group Research*

**Different economic development within V4 also affected by financial crisis**

The divergence in economic development between the V4 countries has been strongly affected by the financial crisis - the vulnerability of the countries as well as policy responses. Due to the already high level of public and external debt, Hungary had far fewer policy options at the beginning of the crisis compared to the Czech Republic, Poland and Slovakia, which could afford to let automatic stabilizers increase their deficits. Also, the Czech Republic and Poland were less dependent on capital inflows, while currency depreciation did not have such a devastating effect on consumers as in Hungary (because of fewer FX loans in PL or no FX loans in the Czech Republic).

**Current account balance of V4 (EUR bn)**


*Source: Eurostat, Erste Group Research*

**V4 more resilient to crisis, with C/A close to zero**

After 10 years of EU membership and a sharp adjustment in the external balance, the V4 region is more resilient to crises. The current account has narrowed close to zero, from the EUR 20-40bn seen in the previous decade. This means that the region is less dependent on net capital inflows and that the current growth trajectory is more sustainable. Besides France and UK (with CA deficits at EUR 27bn and EUR 83bn, respectively in 2013) there is actually no EU country running a large current account deficit anymore.

**Jan Jedlička**
Česká spořitelna EU Office

# Main advantages of EU membership for V4 countries

## Single market

**EU membership gave V4 access to more than 500mn customers, opened labor markets and helped them to reap benefits of European services liberalization**

Becoming part of the EU opened up new opportunities for companies in the V4, as they gained access to a single market with more than 500mn customers. This bore fruit, with growing export dynamics across all V4 countries, which has been well demonstrated in the previous chapter. Although the single market for goods has already been formally completed, there is room to deepen the single market for services, as in some areas there are still protectionist hurdles (for example in transportation). Opening the labor market (albeit with some delay) encouraged a wave of migration of the labor force from the V4, with a positive impact on the unemployment rate in the region and positive flow of remittances to the V4. V4 countries have also benefited from the liberalization of markets; in particular, monopolized sectors (e.g. energy, telecommunication and aviation) had to open to competition, with positive effects on consumers.

## Financial transfers and subsidies

There have been clear financial benefits of EU membership, especially for the less developed countries, in the form of EU support programs.

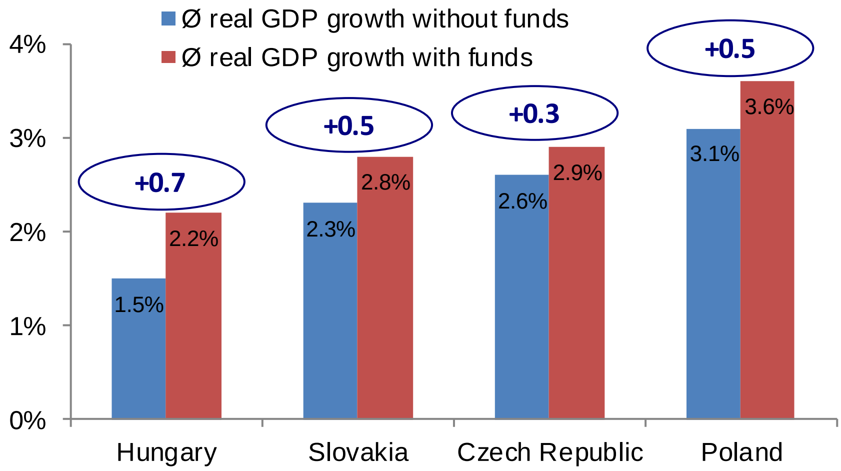
**EU funding plays critical role in V4, enabling projects that improve infrastructure and environment, support SMEs**

**The Cohesion Policy**, which targets mitigating regional differences in the European Union, has been the most important – at least from the budget perspective. In the previous budgeting period 2007-13, the V4 were granted a budget worth EUR 130.9bn (2.8% of annual GDP on average) to be spent on investments. Infrastructure projects consumed the highest share of EU funds across the countries, with the environment being the second and SME support and R&D investments in third place. The positive impact was mostly seen in Poland, where higher public investment during the crisis significantly helped the country to avoid recession in 2009.

**EUR 135.4bn earmarked for V4 within Cohesion Policy 2014-20**

In our report "Cohesion Policy and other EU assistance programs in 2014-20[5]", we concluded that the allocation of subsidies from EU funds in the next programming period could reach the scale of a "Marshall Plan" for the region. The earmarked figure for V4 countries amounts to EUR 135.4bn in 2014-2020. We calculated the positive effects of the Cohesion Policy on GDP growth. If the European funds are used effectively for investments that spur development, the annual rate of growth should accelerate from 0.3% in the case of the Czech Republic to 0.7% in Hungary. The average contribution coming from utilizing EU funds for Poland and Slovakia should be around 0.5%.

**Average contributions of EU funds to annual GDP growth in 2014-2020**




*Source: EC, Erste Group Research calculations, EU Office of Česká spořitelna*

**CAP has influenced agricultural landscape across V4 through financing for new technologies and supporting farmers**

**The Common Agricultural Policy** (CAP) helps to improve the financial situation of farmers in the V4 region and enabled agricultural business in mountainous and less productive areas. Although before EU accession the agriculture sector in V4 countries was characterized by under-capitalization and old technologies, the agriculture business now belongs among the low-risk and profitable sectors. Beside food production, rural areas are valued for their offer of recreational activities and aesthetic values. Therefore, another part of the CAP is focused on financing activities in the area of tourism, handicrafts and culture. The total allocation of the CAP for V4 regions in 2014-20 amounts to EUR 57.4bn.

5 http://www.erstegroup.com/en/Press/Press-Releases/Archive/2014/3/11/EU-Cohesion-Polica-2014-2020~Research-Zentral-Osteuropa

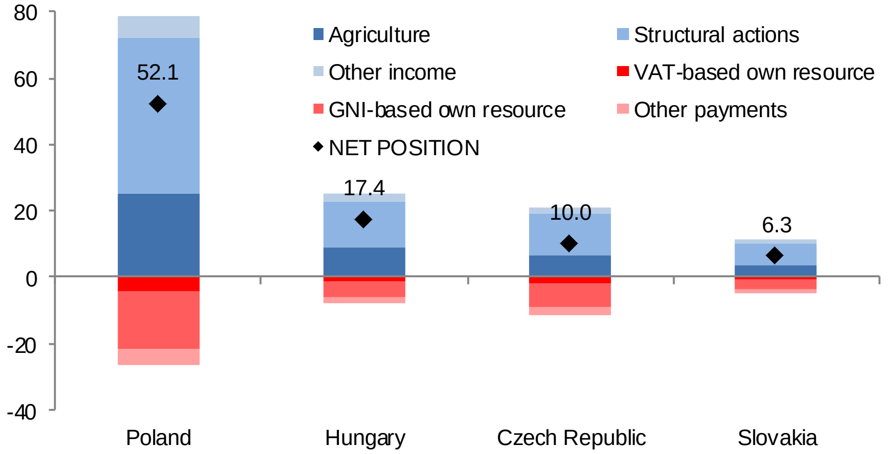
**EU programs Horizon, Connecting Europe Facility and Erasmus complement range of EU instruments available to V4**

**Other European programs:** Alongside the subsidy from Cohesion or the Common Agricultural Policy, the V4 countries also benefit from other European assistance programs. The most useful for the V4 region are **Horizon,** focusing on R&D investments, the **Connecting Europe Facility,** financing Trans-European transport, energy and telecommunication infrastructure, and **Erasmus,** enabling the exchange of students and teachers throughout the EU.

## Positive net position towards common EU budget

In all V4 countries, the incomes from the EU to national budgets have visibly overwhelmed the national payments into the EU and their net position toward the EU budget has always been positive.

**Cumulative net position of V4 countries towards the EU budget in 2004-2012 (EUR bn)**




*Source: European Commission*

**Incomes from common EU budget in V4 countries significantly overwhelm their payments into it**

The major source of incomes from the EU budget was earmarked for structural actions, alias the Cohesion Policy, with its share oscillating between 55.8% in Hungary and 59.1% in the Czech Republic. On the opposite side of the budget, around 2/3 of total payments are comprised of so-called GNI-based own resources, which is a payment based on the gross national income of member states.

## Key challenges for future

**All V4 countries have to comply with the Fiscal Compact requirements. Hungary struggles the most, given its high sovereign debt level**

During the financial crisis, it has been proven that the old criteria that aimed to keep public finances prudent have not been efficient. This year, all V4 countries will comply with 'the old' 3% deficit ceiling; however, the new fiscal rules defined by the Six-pack and later reinforced by the **Fiscal Compact** set more ambitious targets. According to the new rules, countries have to bring their structural deficit to as low as 0.5% or 1% of GDP (depending on the level of debt) and gradually reduce any excessive debt topping 60% (which only affects Hungary). Out of the V4 countries, Slovakia, Poland and Hungary signed this Fiscal Pact already in spring 2012 and the Czech Republic decided only in March 2014 to ratify it. The Fiscal Pact should ensure more prudence in budgeting. in particular, it will prevent governments from overspending during the good times and give more fiscal space during the downturns, as governments will not be pushed into self-defeating austerities.

**Joining the Eurozone and European Stability Mechanism remains an open question for the V4 in the next decade**

Although all of the V4 countries committed themselves to adopting the euro, only Slovakia has joined the Eurozone so far. In the other V4 countries, it is not a current topic, and their entry is likely only at the end of this decade, when the countries will fully comply with the Maastricht criteria (and Fiscal Compact) and the new design of the Eurozone will be better known. The long-term benefits stemming from the openness of the V4 economies and their export orientation toward the Eurozone are strong factors for euro adoption. However, in the short term, some negatives and risks are hard to overlook. Poland, Hungary and the Czech Republic do not create an optimal currency area with the Eurozone at this moment. The common monetary policy is struggling due to the heterogeneity of the Eurozone. In addition, new risks connected to the debt crisis and the need to contribute to the European Stability Mechanism (ESM) scare politicians. Disputes about the ESM led to the fall of the Radicová government in Slovakia in 2011. According to our estimates, the capital contribution of Hungary, the Czech Republic and Poland into the ESM will hover between EUR 12.4bn in the case of Hungary and EUR 45.9bn in the case of Poland. The contributions to the rescue mechanism are treated as financial assets (investment), while the common perception in the public is that those are just costs that do not have any benefits.

**Estimated subscribed capital of V4 countries into ESM**

| EUR bn | Capital subscription | Paid-in capital | Guarantees |
|---|---|---|---|
| Poland* | 45.9 | 5.2 | 40.7 |
| Czech Republic* | 14.4 | 1.6 | 12.8 |
| Hungary* | 12.4 | 1.4 | 11 |
| Slovakia | 5.8 | 0.7 | 5.1 |

*Source: ESM, ECB, Česká spořitelna EO Office, *) estimation by Česká Spořitelna EU Office under assumption that Eurozone equals current EU-18 + CR, Hungary and Poland, Capital subscription = paid-in capital + guarantees*

**Main tasks confronting V4 are to improve EU fund absorption, reduce bureaucracy, move towards tighter regional cooperation**

In times of fiscal consolidation, **EU funds** represent one of the few sources for fiscal and investment stimuli in the V4. The big challenge is to use them effectively and to increase the still unsatisfactory absorption rate. Among the V4 countries, only Poland managed to draw two thirds (67.9%) of its EU funds allocated for the previous 2007-13 period as of the end of 2013[6]. The Hungarian absorption rate (59.3%) is average, while Slovakia (52.6%) and the Czech Republic (51.1%) recorded poorer absorption. In order to improve absorption and the socio-economic effects of subsidies from EU funds, the V4 need to significantly reduce bureaucracy, introduce more transparent processes of project selection and establish closer regional cooperation.

**Due to presence of financial institutions with cross-border operations, banking union is important for V4 as well; taking passive attitude or even contrary one would be counterproductive.**

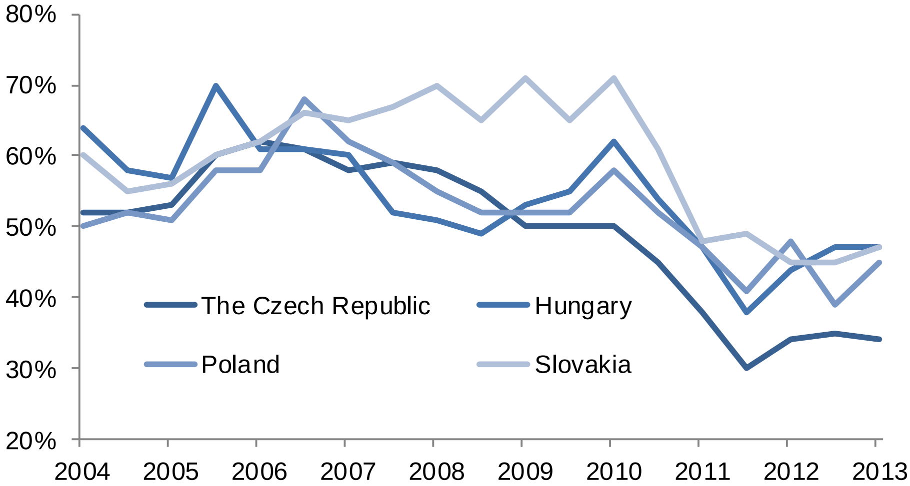
**The banking union** is another project where participation is binding for all Eurozone countries, including Slovakia, but voluntary for EU members outside the Eurozone. Poland, Hungary and the Czech Republic decided to stay out, as their banking sector is healthy and solid, and therefore these countries - at least in the medium-term horizon - would not use the assistance from banking union mechanisms. However, it is important that these countries are not blocking the negotiations on it and are actively involved in the discussion at the EU level.

[6] According to the N+2 rule, the countries have two more years (until end-2015) to spend money from EU coffers devoted to 2007-13 period.

**The V4 countries have the potential for greater regional cooperation. Improvement in this area could mean that the region would have its voice heard in the international arena.**

This is especially true for the Czech Republic, Slovakia and Hungary, which belong among the small to medium-sized EU members. If they want to pursue their interests at the EU level, they need to form a coalition with their natural partners – other V4 countries. All V4 countries together have 64.4mn people (more than the UK); in the EU Council, only Germany and France have a stronger voice (derived from the population). In the European Parliament, they have (with 106 MEPs) altogether an even stronger position than Germany, with 96 MEPs.

**Share of answers 'Tend to trust' to the question 'How much trust do you have in the EU?'**




*Source: Eurobarometer*

Another big challenge for the common European future is the potential clash of two opposing trends that are primarily connected with the current debt crisis and the adopted measures. These measures are on one hand heading for a natural acceleration of the integration process in the EU, but on the other hand are unpopular among the citizens, leading to stronger support for euro-skeptic political parties. A similar development is also obvious in the V4 region. The European Union was at its peak of popularity during the first couple of years after enlargement in 2004. Since 2008, when the financial crisis began, we have been able to identify a trend of decreasing EU popularity, due to austerity measures and the global economic slowdown.

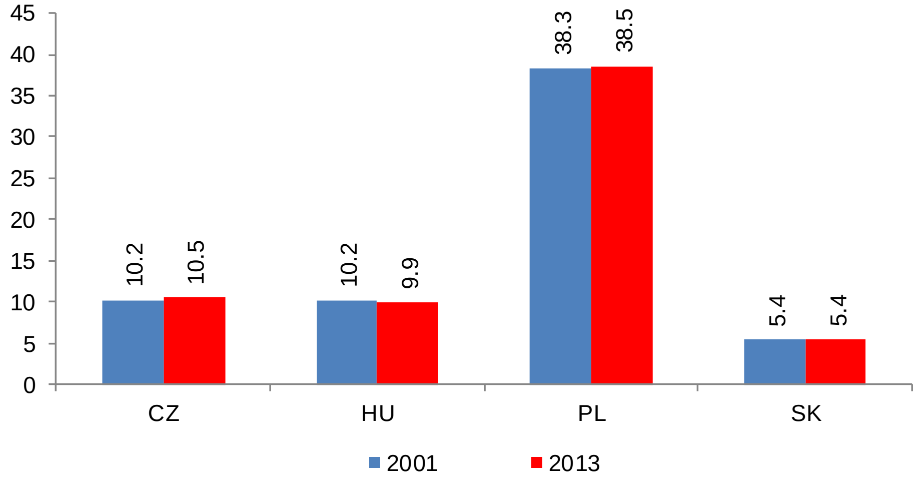
**Rainer Münz**
Head of Research & Knowledge Center

# Population trends in V4 and geopolitics

## Population in Central Europe: General Trends

Today, some 99mn people live in CEE countries that became members of the European Union in 2004, 2007 and 2013. Of them, 64mn are inhabitants of the V4 countries. They represent almost 13% of all people living in the European Union. Population-wise, the largest of these countries in the region is Poland, with 38mn inhabitants. The smallest V4 country is Slovakia (5.4mn).
The Czech Republic and Poland have a growing population. In contrast, Hungary is experiencing a population decline, with more deaths than births as well as more people leaving than returning or immigrating from third countries.

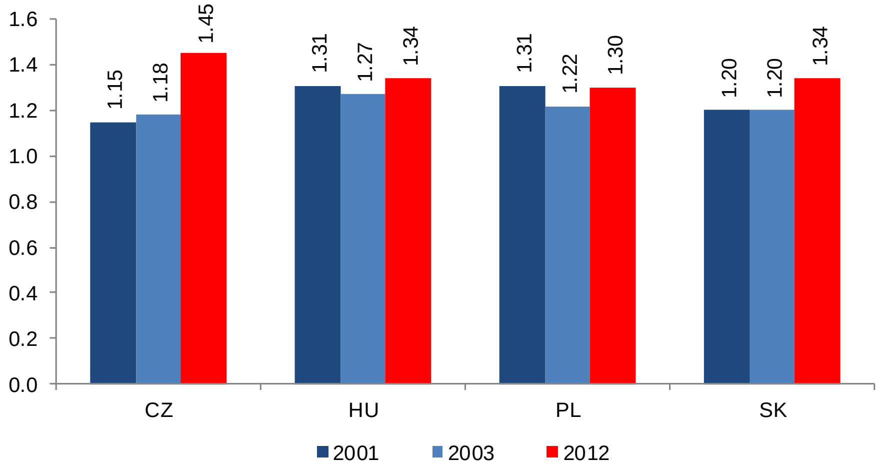
**Population of V4 countries (in mn.)**




*Source: Eurostat*

Demographically speaking the CEE region follows general European trends: Low birth rates and increasing life expectancy. In all V4 countries the average birth rate is below the European average of 1.6 children per woman. Today, Poland has the lowest fertility rates, both with 1.3 children per woman.

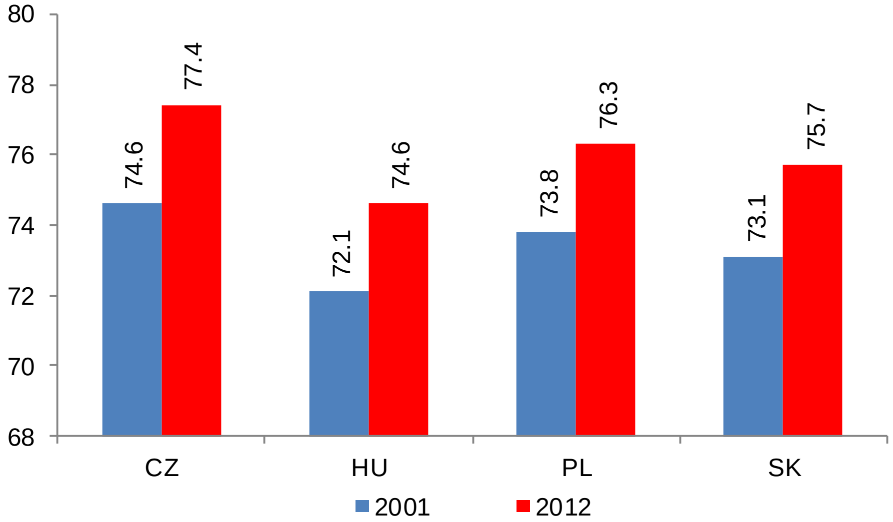
**Average number of children per woman in V4 (Total fertility rate)**




*Source: Eurostat*

Life expectancy in the V4 is below the European average, but all countries are catching up as living conditions – also documented in the perceived quality of life (see the first chapter) – have improved over the last 20 years. The most important factors contributing to this are lower levels of industrial pollution, improved quality of food and access to better health care, as well as a declining number of people doing heavy labor. In the V4 region, the Czechs (men: 74 years; women: 80 years) live the longest. The lowest life expectancy in the V4 is recorded in Hungary (men: 71 years; women: 78 years).

**Life expectancy at birth in V4 (in years)**




*Source: Eurostat*

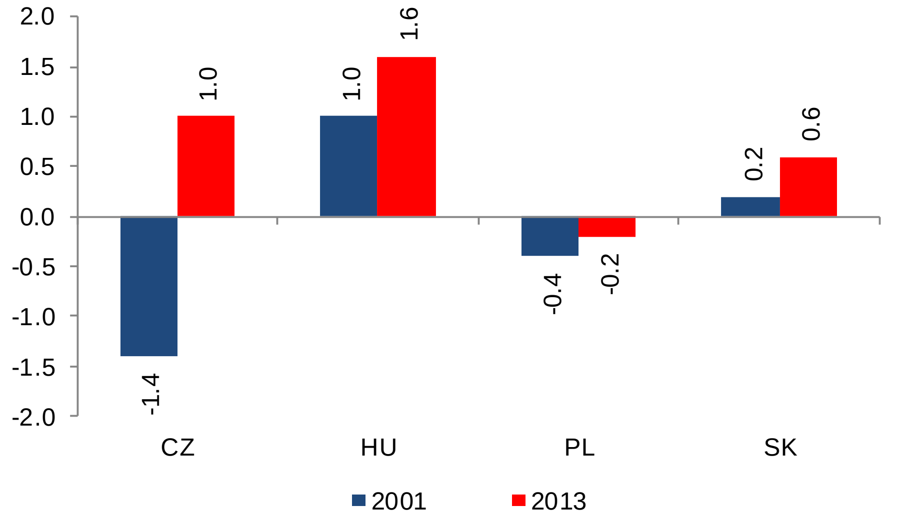
In the coming years, low fertility and increased life expectancy will lead to continued demographic aging characterized by a decreasing number of young people and a growing number of elderly citizens.

International migration and regional mobility also play an important role in shaping the size and distribution of populations in CEE. Over the past 20 years, the majority of CEE countries have experienced more emigrants than immigrants. In the V4 countries the picture is mixed. Hungary always had a positive migration balance due to ethnic Hungarians immigration from neighboring countries (namely Romania, Serbia and Ukraine). The Czech Republic and to a smaller degree also Slovakia has seen immigration increasing while in the case of Poland a sizeable number of citizens moved to Western EU countries in search of employment. Many migrants came – and still come – from rural areas and small towns.

Intra-European East-West migration already took off after the fall of the Iron Curtain, but also reflects mobility induced by the enlargement of the European Union in the years 2004, 2007, and 2013 and better access to Western European labor markets.

Socio-economic changes before and after EU membership also led to higher mobility within V4 countries. With economic growth, higher education and modern health care concentrated in urban agglomerations, many citizens of V4 countries see mobility within their own countries as an alternative to international migration.

**Net migration rates (%)**




*Source: Eurostat*

In absolute terms, the main V4 countries exporting labor were Poland and Hungary. Some V4 migrants have left their countries for good. Others have returned – many of them in the aftermath of the recent economic and financial crisis, given that the major destination countries for CE migrants (like Spain, Italy and Greece, but also the UK and Ireland) have been particularly hit hard by the crisis.

In the future all CEE countries will experience demographic ageing. As a result, there will be less people entering the labor market. We can therefore assume that sooner or later in all V4 countries immigration will become more important than today. Given today's and tomorrow's excess of deaths over births, the ability to attract, absorb and integrate migrants will also decide about the future size of working age populations and indirectly also about economic growth potentials. Unless V4 countries are prepared to undertake significant efforts to attract skilled labor from abroad in the medium term, it is foreseeable that work force shortages will hurt potential GDP growth significantly throughout the region.

## V4 in geopolitical landscape

Since the fall of the Iron Curtain, the geopolitical situation and role of the four Visegrad countries within Europe has changed fundamentally. The collapse of the Soviet Union and of the dissolution of the Warsaw Pact made way for the expansion of NATO into territories formerly controlled by the Red Army and its allies. In Central Europe, all Visegrad countries applied and became NATO members.

Geopolitical change also led to another expansion: EU enlargement. At first, three non-aligned countries – Austria, Finland and Sweden – joined the EU in 1995. Their membership had formerly been objected to by the Soviet Union and was directly triggered by the end of the Cold War. Nine years on, in 2004, as a result of their transition to market economies, the four Visegrad countries, the Baltic states and Slovenia became EU members, followed later by Bulgaria, Romania (2007) and Croatia (2013).

Membership in both NATO and EU helped the four Visegrad countries integrating economically with their Western neighbors and into transatlantic security structures. As a result some of their troops served in places like Iraq and Afghanistan. NATO membership has also led to more regional integration: All four Visegrad countries cooperate in the area of defense procurement. They are planning to set up joint battle groups. And Hungary's air force is policing Slovenia's air space.

From a geopolitical point of view Poland has profited the most from NATO and EU membership. It is the only country in the region that is able to deal more or less at par with France and Germany and pursue a genuine foreign policy. The so-called Weimar triangle has institutionalized consultations at government level between Poland, France and Germany. The recent crisis in Ukraine has also shown Poland's weight as a regional actor trying to broker arrangements between the different local actors.

Today, given increased tensions between Russia and the West over Ukraine, a majority of citizens in all four Visegrad show sympathy for the pro-Western camp in Kiev. As three of the four share a common border with Ukraine EU and NATO membership is now even more seen as an anchor and backstop of their national security. At the same time the high share of gas supply from Russia delivered via Ukraine reminds the Visegrad four (and other CEE countries) of their energy dependence on Russia.

# Country specific comments:

**Czech Republic (David Navratil):** "Sound in body, unsound in mind" is the best description of the Czech economy. Looking at fundamentals, you can see an economy with low debt in all sectors (government, households and companies), no external or internal imbalances, a banking sector with a liquidity surplus and high capital adequacy ratio, a competitive industry whose competitiveness has even increased in the last ten years, as productivity exceeded wage inflation; industry is closely connected to the effective Germany/CEE production cluster… In other words, the Czech economy has prerequisites to be at the top of the economies with the strongest convergence story and which are "sound in body". However, this has not been the case. Since 2009, the average growth has been -0.4%. The reason is not industry, exports, i.e. productivity or low ROE. If the economy is only about exports, the average growth would have been +1% since 2009, in spite of the recession in the EMU. The weakness is connected to domestic demand, the lousy mood and excessive fiscal restriction. In 2012, Czechs were the second most pessimistic nation in the world, according to a Gallup survey. The first was Greece. The difference in fundamentals between the Czech Republic and Greece is so obvious that "unsound in mind" is the only explanation. To release the bottleneck, the Czech economy needs to decrease its perceived corruption and improve the effectiveness of its institutions. Both are a priority of the new government, alongside investment support. Long-term priorities have to be energy diversification and an increased share of technical graduates to fully utilize the industrial potential.

**Hungary (Gergely Gabler):** The intensifying of foreign trade has been the most important advantage of EU accession. Last year, total exports rose to a record high of EUR 81.8bn, of which 77% was EU-oriented. Nonetheless, the heavy inflow of EU funds (5.5% of GDP in 2013, 2.4% 10-year average) is also one of the main arguments in favor of Hungary's EU membership.

However, this has also brought some negative effects, as the distribution of EU funds has proved neither effective nor optimal. Furthermore, it has supported economic structural problems, such as high public distribution (50% of GDP) and low employment (53%). Hungary's major challenge for the coming years is to achieve significant improvements in these fields in order to boost the current too low (0.8%) growth potential.

**Poland (Katarzyna Rzentarzewska):** Apart from the well-recognized economic benefits arising from deepening integration, the opening up of the labor market was one of the most beneficial changes for Poland. The unemployment rate dropped visibly and the inflow of remittances increased, positively impacting households. Moreover, the boost in public investment before the Euro Championship in 2012 would probably not have been as strong had it not been for EU funds. These saved Poland from recession when all of Europe was coping with the crisis. We believe that increases in R&D spending and the economy becoming innovation-based are the greatest challenges ahead of Poland.

**Slovakia (Martin Balaz):** The deepening of economic integration, especially in foreign trade, has been the main benefit of EU membership. On top of that, Slovakia, as the only V4 country to join the Eurozone, rid itself of FX volatility and thus differentiated itself from its peers. However, the adoption of the euro came with some costs which were unknown at the time. Fixing the convergence rate at a very strong level backfired during the crisis. Slovak retail prices and labor costs became extremely expensive compared to those regional peers where currencies depreciated. The labor market thus became the main shock absorber, which is why unemployment spiked much more than in neighboring countries. The overhaul of public institutions and improvement of labor market flexibility remain the main challenges for Slovakia in future.

# Appendix

### Car production (in mio)

| | Germany | V4 | Spain | France | UK | Czech Republic | Slovakia | Italy | Poland | Belgium | Romania | Hungary | Austria | Sweden | Portugal | Slovenia |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2003** | 5.507 | 1.171 | 3.030 | 3.620 | 1.846 | 0.442 | 0.281 | 1.322 | 0.322 | 0.904 | 0.095 | 0.126 | 0.140 | 0.323 | 0.239 | 0.118 |
| **2013** | 5.718 | 2.914 | 2.163 | 1.740 | 1.597 | 1.133 | 0.975 | 0.658 | 0.583 | 0.480 | 0.411 | 0.222 | 0.171 | 0.161 | 0.154 | 0.094 |

*Source: OICA, Erste Group Research*

### Quality of life ranking

| | Sweden | Luxembourg | Netherlands | Austria | Denmark | Slovenia | Finland | Germany | France | Belgium | Malta | Ireland | Czech Republic | Cyprus | Italy | United Kingdom | Poland | Spain | V4 average | Slovakia | Portugal | Lithuania | Greece | Romania | Hungary | Estonia | Latvia | Bulgaria |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2003/2005 | 5.2 | 6.2 | 10.1 | 7.2 | 7.6 | 11.0 | 10.5 | 11.2 | 12.3 | 11.3 | 11.5 | 9.9 | 15.5 | 14.1 | 12.6 | 12.3 | 18.0 | 14.2 | 17.8 | 20.2 | 15.7 | 22.3 | 15.9 | 20.5 | 17.4 | 21.8 | 22.7 | 21.5 |
| 2013 | 5.1 | 5.1 | 6.4 | 6.8 | 9.7 | 10.3 | 10.4 | 10.7 | 10.7 | 11.6 | 11.9 | 12.9 | 13.6 | 13.7 | 13.8 | 14.2 | 15.2 | 15.4 | 16.5 | 16.8 | 17.8 | 19.3 | 19.6 | 20.5 | 20.6 | 21.1 | 22.4 | 22.9 |

| improved (+) worsened (-) position | Netherlands | Slovakia | Lithuania | Poland | Czech Republic | France | V4 average | Luxembourg | Estonia | Slovenia | Germany | Cyprus | Austria | Latvia | Sweden | Finland | Romania | Belgium | Malta | Italy | Spain | Bulgaria | United Kingdom | Portugal | Denmark | Ireland | Hungary | Greece |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 3.7 | 3.5 | 3.0 | 2.8 | 1.9 | 1.6 | 1.2 | 1.1 | 0.8 | 0.7 | 0.5 | 0.4 | 0.4 | 0.3 | 0.2 | 0.0 | 0.0 | -0.4 | -0.4 | -1.2 | -1.2 | -1.5 | -1.9 | -2.1 | -2.2 | -3.0 | -3.2 | -3.8 |

*Source: Eurostat, Erste Group Research*

### Cumulative net position of V4 countries towards the EU budget in 2004-2012 (EURbn)

| | NET POSITION | Agriculture | Structural actions | Other income | VAT-based own resource | GNI-based own resource | Other payments |
|---|---|---|---|---|---|---|---|
| Poland | 52.1 | 25.5 | 46.4 | 6.8 | -4.1 | -17.8 | -4.8 |
| Hungary | 17.4 | 9.0 | 14.0 | 2.1 | -1.0 | -5.2 | -1.5 |
| Czech Republic | 10.0 | 6.6 | 12.6 | 2.1 | -1.6 | -7.4 | -2.4 |
| Slovakia | 6.3 | 3.7 | 6.3 | 1.2 | -0.6 | -3.2 | -1.1 |

*Source: European Commission*

**Share of answers 'Tend to trust' to the question 'How much trust do you have in the EU?'**

| | Czech Republic | Hungary | Poland | Slovakia |
|---|---|---|---|---|
| 2013-Nov | 34% | 47% | 45% | 47% |
| 2013-May | 35% | 47% | 39% | 45% |
| 2012-Nov | 34% | 44% | 48% | 45% |
| 2012-May | 30% | 38% | 41% | 49% |
| 2011-Nov | 38% | 47% | 47% | 48% |
| 2011-May | 45% | 54% | 52% | 61% |
| 2010-Nov | 50% | 62% | 58% | 71% |
| 2010-May | 50% | 55% | 52% | 65% |
| 2009-Nov | 50% | 53% | 52% | 71% |
| 2009-May | 55% | 49% | 52% | 65% |
| 2008-Nov | 58% | 51% | 55% | 70% |
| 2008-May | 59% | 52% | 59% | 67% |
| 2007-Nov | 58% | 60% | 62% | 65% |
| 2007-May | 61% | 61% | 68% | 66% |
| 2006-Nov | 62% | 61% | 58% | 62% |
| 2006-May | 60% | 70% | 58% | 60% |
| 2005-Nov | 53% | 57% | 51% | 56% |
| 2005-May | 52% | 58% | 52% | 55% |
| 2004-Nov | 52% | 64% | 50% | 60% |

*Source: Eurobarometer*

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