

Real and Nominal Convergence in the European Union

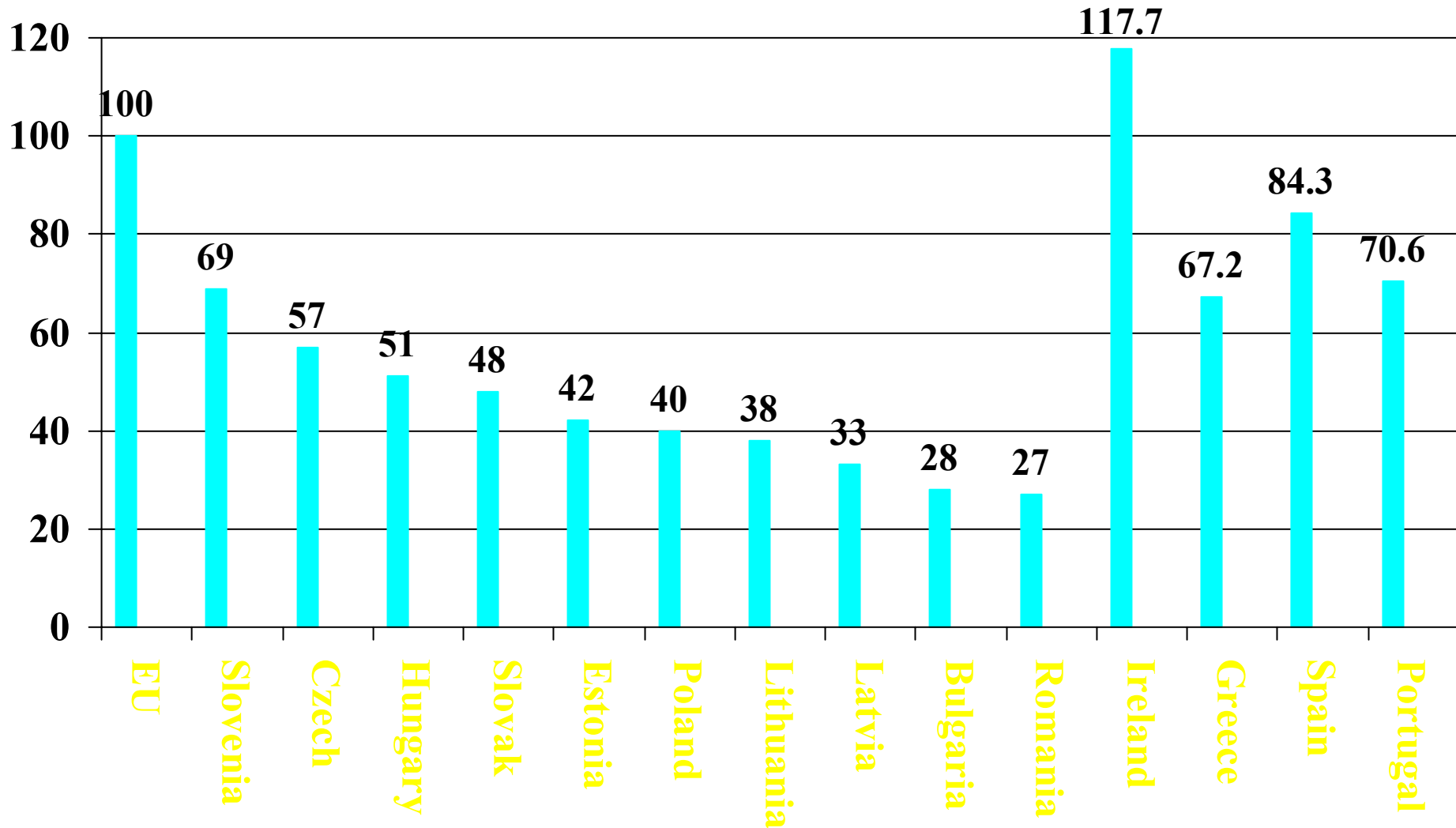
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Benefits for the new member countries

- Accession driver of reforms in the CEECs
- Expectations of increased political stability and economic prosperity
- Catching up with western Europe

Per capita GDP in PPP as % of EU GDP, 2001



GDP per capita (PPP) as a percent of EU average

	1973	1981	1986	2000
Ireland	59			119
Greece		62.4		68.6
Portugal			50	73.6
Spain			70	81

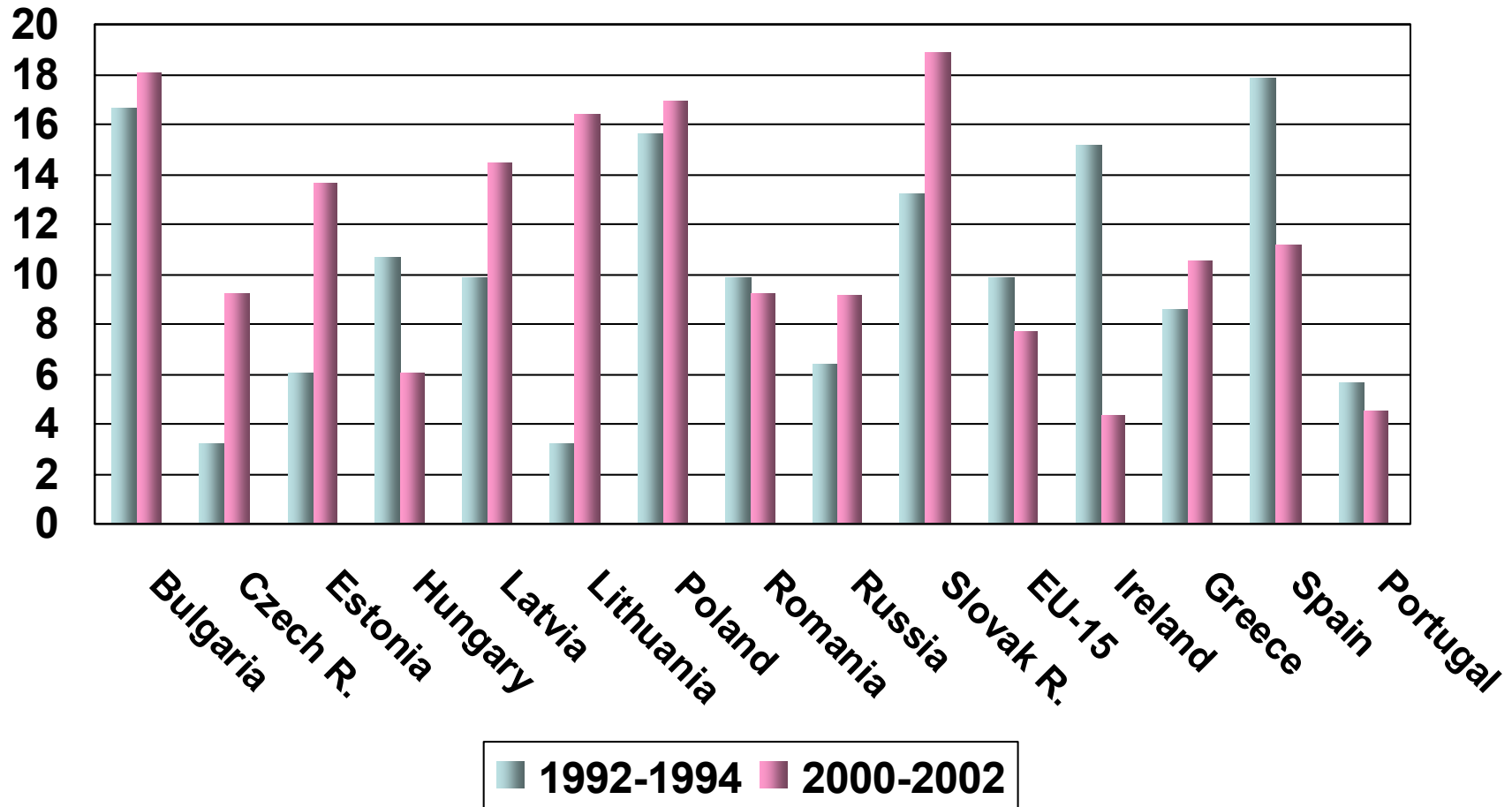
By what rate do CEEC need to grow for convergence to occur in 20/30 years, assuming EU15 grows at 2% pa ?

	100% target		75% target		50% target	
	20	30	20	30	20	30
Czech Rep	4.9	3.9	3.4	2.9	na	na
Estonia	6.5	5.0	5.0	4.0	2.9	2.6
Hungary	5.5	4.3	3.9	3.3	na	na
Latvia	7.8	5.8	6.2	4.8	4.1	3.4
Lithuania	7.1	5.4	5.6	4.4	3.5	3.0
Poland	6.8	5.2	5.3	4.2	3.2	2.8
Slovak Rep	5.8	4.5	4.3	3.5	2.2	2.1
Slovenia	3.9	3.3	2.4	2.3	na	na
Romania	9.1	6.8	7.7	5.7	5.5	4.3
Bulgaria	9.7	6.4	7.1	5.4	5.0	4.0

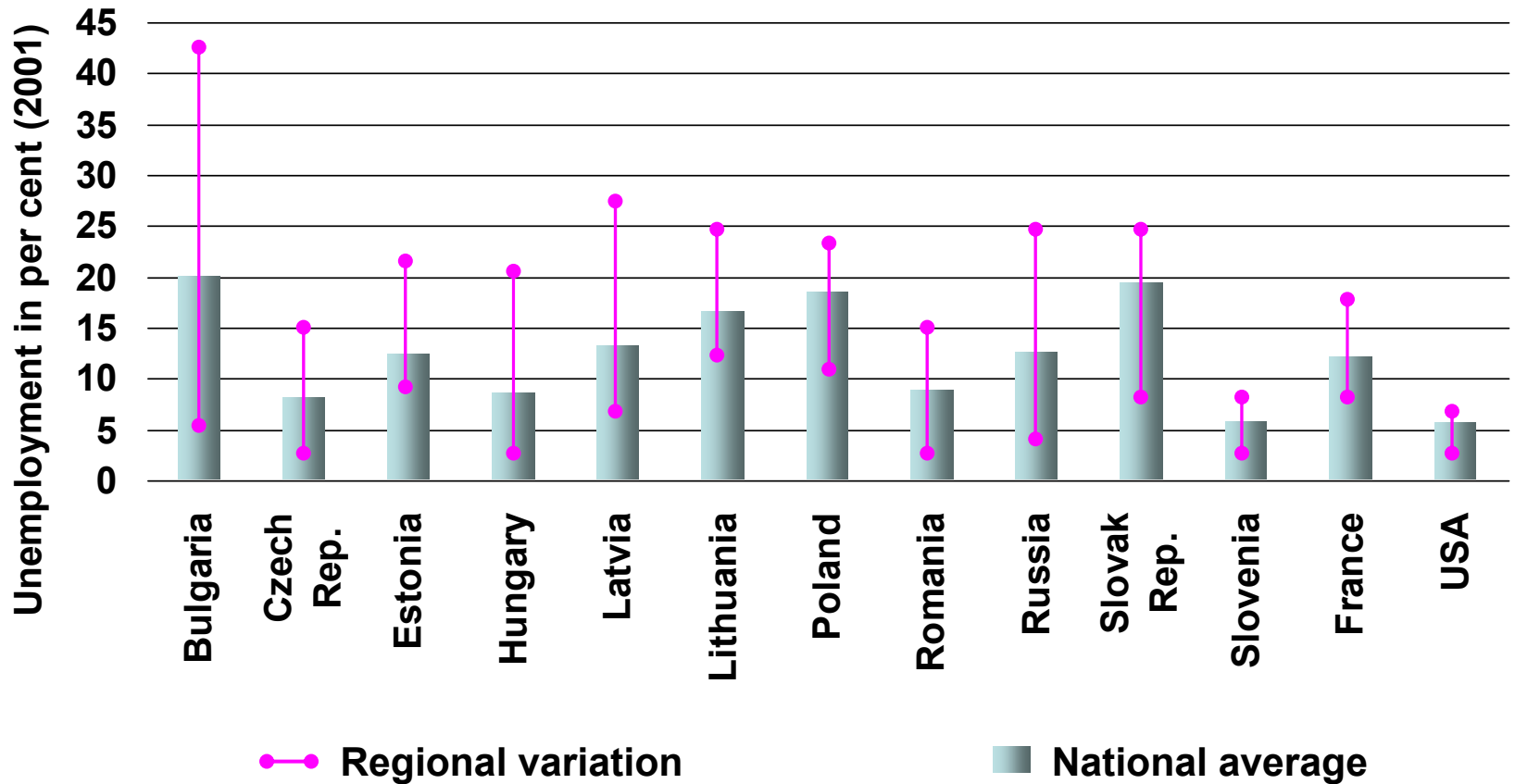
Growth rates 2003 -2004 stronger than in EU-15

	2003	2004
Czech Republic	2.9	4.0
Estonia	4.7	5.5
Hungary	2.9	5.0
Latvia	7.5	6.0
Lithuania	9.0	6.5
Poland	3.7	4.5
Slovak Republic	4.2	4.4
Slovenia	2.3	3.1
Ireland	1.2	3.7
Greece	4.7	4.0
Spain	2.4	2.8
Portugal	-1.3	0.8

...But, Rising Unemployment



Large regional dispersion of unemployment



Features of Regional Unemployment

- Regional (within each new member country) dispersion of unemployment has been large and increasing
- Relative differences between regions remained the same
- Strong and increasing correlation between regional unemployment and non-participation rates

Why?

- Empirical evidence (Bornhorst and Commander, 2003) found that wage adjustment mechanism are insufficient to reduce regional employment differential.
- Labour mobility has played a very small role in bringing about regional equilibrium.

Why do Cross-border and national mobility remain limited?

- A lack of domestic labour market integration and immigration barriers in OECD
- Worker compensation linked to non-monetary benefits (housing, childcare)
- Owner-occupied housing was the norm; lack of clarity over property rights; low quality housing stock
- Lack of long-term housing finance

Future policies need to address

- Failures in domestic housing markets and finance
- Lack of adequate labour market information and institutions for promoting mobility
- Reappraisal of immigration policies in OECD
- Availability of housing finance
- Removal of barriers to opening new bank branches

Nominal Convergence: EU and EMU membership

- EU membership implies EMU membership – part of ‘Acquis’; no more indefinite opt-outs (Denmark, UK).
- However, duration of derogation for euro adoption is open-ended : no timing requirement to enter ERMII ; once in ERMII, exchange rate & other EMU criteria may not be met (intentionally or accidentally).

EMU membership path

- Inflation (no more than 1.5% above average of 3 lowest inflation countries)
- Nominal interest rate (10 year rate no more than 2.0% above average of 3 lowest inflation countries)
- Nominal exchange rate
 - Respect normal fluctuation margins for ERM without severe tensions for at least 2 years before the examination. No devaluation 'on own initiative'. [Question: can one 'respect normal fluctuation margins for ERM' without being an ERM (and therefore an EMU) member? If not, at least 2 years of ERMII plus unrestricted financial capital mobility: risk of speculative attacks and crises]. Italy and Finland precedents 1998/9; Greece precedent 2000/1.
 - Council of Ministers decides conversion rate
- Financial
 - Deficit < 3 % of GDP
 - Debt < 60 % of annual GDP
- Central Bank independence

The macroeconomic challenges

- For sustained growth, it will be necessary to get the fiscal/monetary policy mix right (also in order to meet the Maastricht criteria). Data for 2003.

In percent	Inflation	Fiscal deficit/GDP	Gross Public debt/GDP	Current Account/GDP
Bulgaria	2.3	0.0	46.1	-8.3
Czech R	0.2	-5.8	23.0	-6.5
Estonia	1.3	0.4	5.1	-13.7
Hungary	4.7	-5.6	58.2	-6.5
Latvia	3.0	-2.0	17.5	-9.3
Lithuania	-1.2	-1.9	24.4	-6.6
Poland	0.7	-6.9	50.6	-1.9
Romania	15.4	-2.4	26.1	-6.0
Slovakia	8.5	-3.6	42.8	-0.6
Slovenia	5.6	-1.4	26.0	0.04