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INFLUENCE OF THE FOREIGN ENVIRONMENT AND THE FINANCIAL CRISIS ON THE ECONOMIC STABILITY OF THE NEW MEMBER STATES OF THE EUROPEAN UNION

The impact of the foreign economic relations on the new EU member states is studied in this article. Trends of the participation of these countries in the export and the import of goods and services and the reflection of the crisis on the state of the balance of payment are shown. Estimates about the influence of the capital flows and the foreign financing on the economic stability of the newly accepted countries are made. The inflows and outflows of the foreign direct investment are analyzed in relation to the state of the balance of payment as a condition for its stability and defining the reflection of the world fiscal crisis. Conclusions have been made for the sustainability of the region and the opportunities of these countries to use the integration processes in the relations with one another.

JEL: F41; F32; F37

The economic development of the new member countries (NMC) of the European Union (EU) counts importantly as for the functioning of the Union, as well as for their position in the integration processes and mainly for their policy of economic and social cohesion and their accession in the Euro Zone. The last large enlargement of the EU is a challenge to the general state of the European economic space, therefore the macroeconomic stability in these countries is related largely to their interaction with the foreign environment in the course of their participation in the international trade and economic relations.

The new member countries of the EU walked a long way of transformation in the social-economic and political systems.[1] These processes were the foundation of accelerated development of the foreign economic relations with EU as a priority orientation and element for the creation of the future economic structure. In practice this was a second transformation in the set of states shown – applying the *acquis communautaire*, building national structures for its enforcement, adjustment of the national economic structures to the competition policy of the Single internal market, implementing the procedure of the negotiations, and their admission in the EU.[2] The orientation to and the joining the largest regional integration community in the

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[1] This analyses includes the ten countries from Central and Eastern Europe, regarding the similarity of the processes and their importance for Bulgaria. Cyprus and Malta have a different development, therefore they were accepted in Euro zone.

[2] See *Fabrizio, S., D. Leigh, A. Mody*. The Second Transition: Eastern Europe in Perspective. IMF Working Paper N 43, 2009.

world proved to be a challenge for the NMC both for the using advantages from the participation in the European integration, for the development of such foreign relations that will support the use of their national comparative advantages.

Here the judgment is made on the foreign influence in two main aspects – reflection of the joining to the EU on their positions in the world trade and the impact on the foreign financing to the state of the national finance indicators.[3] The two aspects reflect the influence of the world crisis on the individual states and on all the regions. This is how an opportunity is made, for estimations not only about the stability, but also for the participation of these countries in the world trade, and the results from the adaptation to the requirements of the EU as a trade bloc are looked for.

New Member Countries of the EU in International Trade Relations

The participation of the NMC in the world trade is a consequence from the breaking the former system of the regulated trade-economic relations and the openness to the international market with a focus on the existing integration communities. For these in the last ten years was executed a transition to accession to the Single Market requirements and using the short - term static effects from joining the EU customs union. For this contributed the association agreements, which the EU concluded with these countries in the early 1990s, which aimed to create a free trade zone in a ten years period on condition that there is a unilateral asymmetrical decrease in the barriers before the trade of the Union.

The consequence of the agreements results in the growing degree of openness of the economies in comparison with the old member countries. This is particularly revealing for Slovakia, Hungary, Czech Republic, Bulgaria and Estonia, and in smaller degree for Romania and Poland as well.[4] The result from these is the gradual liberalization of the trade with the old member countries and extending their involvement in the internal trade.

The estimates of the latter countries shows (see Figure 1), that after 2000, when the trade in the countries with the agreements with the EU was liberalized in practice, it began to grow, especially after the first joining in 2004. The next joining of Bulgaria and Romania contribute to the boost of the internal trade until 2008, followed by a decrease mostly influenced by the diminished participation of the new member countries (see Figure 2).

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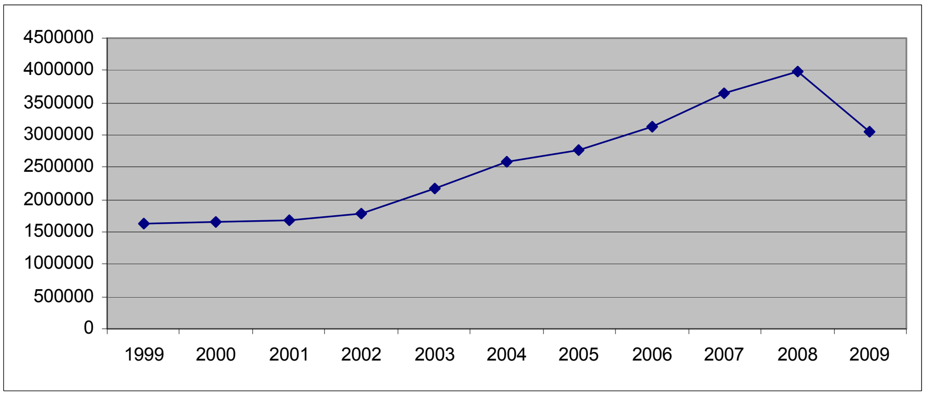
[3] The results of the study, financed by National fund “Scientific research” – Bulgaria, Project RD-491-4/27.06.2008. “Macroeconomic aspects or the stability in the new member countries of the EU.

[4] *See Fabrizio, S., D. Leigh, A. Mody.* Op. cit. p. 7.

Figure 1

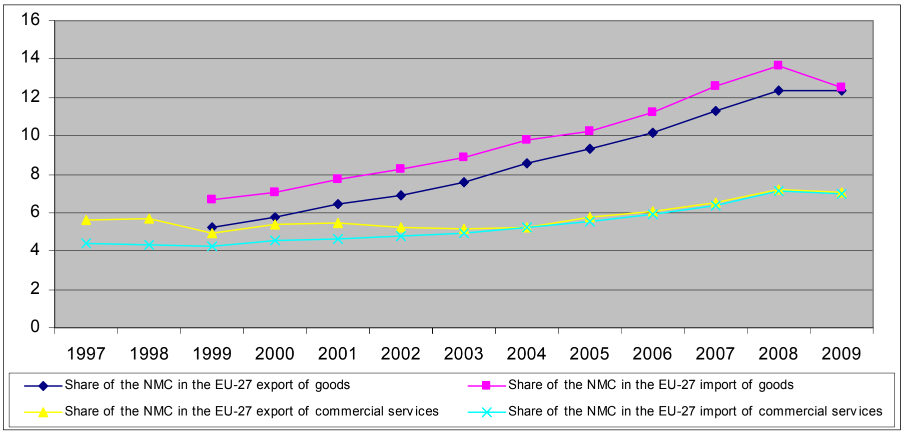
EU internal trade (million USD)



Source. International Trade Statistics. WTO, Geneva, 2010, p. 181-194.

Figure 2

Share of the NMC in the trade with goods and commercial services of the EU-27 (%)



Calculated from International Trade Statistics. WTO, Geneva, 2010, p. 181-194.

In addition to the benefits of the development of intraregional trade the newly joined countries capitalized in significant degree the advantages of the participation in the integration policies and extended their participation in the general trade of the EU. In the last years the share of these countries in the general export of the Union marked a sustainable trend of growth, especially in respect to the trade with goods (see Figure 2). At the same time we should be aware of the reflection of the joining on their international competitiveness and exhausting of their opportunities for the enlargement of their presence on the EU Single Market. After all it is clear that in the conditions of the financial crisis they remain at a relatively stable degree, which can be considered even a dependable participation in the internal trade of the Union.

Services are relatively more stable. This is explained with the lower rates of technology innovation that finds a resonance respectively in the competitiveness. This is why the trade with services remains at a lower level in comparison with the trade with merchandises.

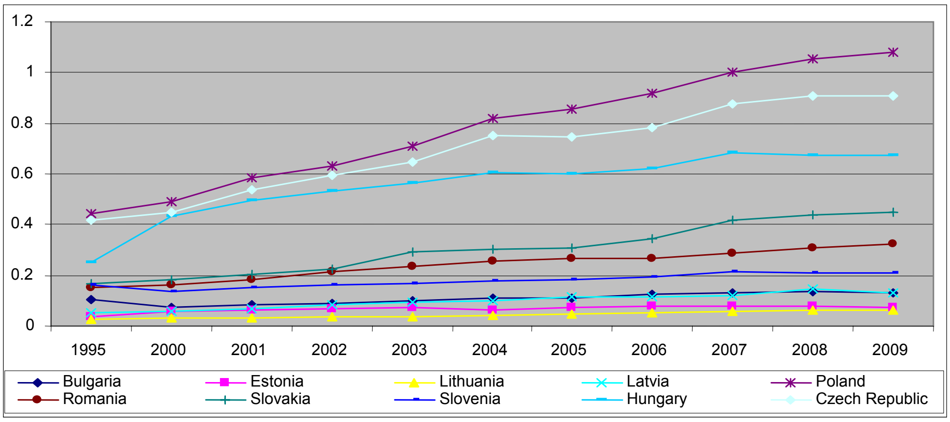
Together with to these trends, it should be pointed out that the share of the NMC in the import of the merchandises is considerably higher due to increased consumption and technical restructuring – mainly in the field of investing merchandises. At the same time, at compounding the world financial crisis, the major presence of these countries in the domestic import of commodities declines to the degree of the export. The reason for this is their connectedness to the leading EU economies.

The import of the services corresponds to the trends in the export which differs from the data on the trade with merchandises, which is higher. This could improve the general trade balance of these countries to a certain degree. Despite it is little influenced by the world crisis, the trade with the services scores relatively stable levels. As a whole it can be stated that the NMC are integrated in the EU from stand of EU philosophy as a trade bloc.

At the same time there are some differences between the individual states with regard to their presence on the Single Market of the EU, and their possibilities for participation in the world trade.

Figure 3

Share of the export of the EU NMC from the world export



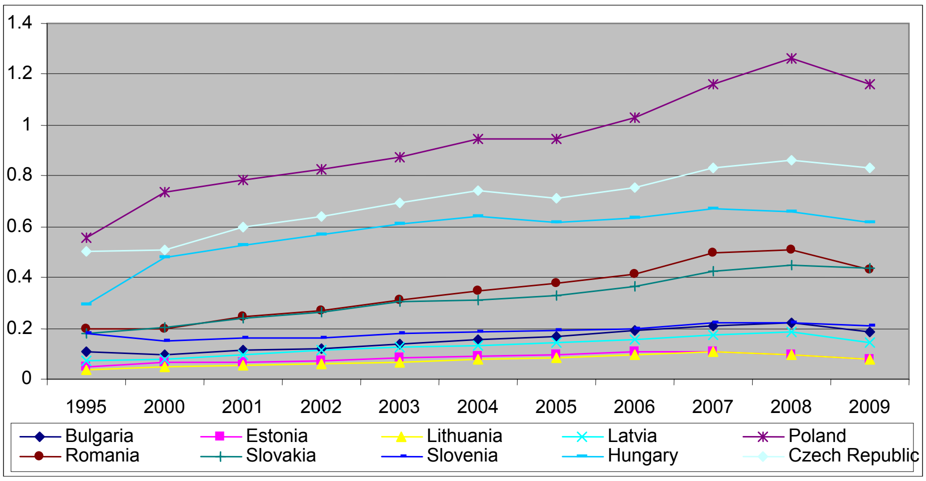
Source. UNCTAD. Handbook of Statistics. UN, New York and Geneva, for correspondent years.

Figure 3 shows that when comparing the separate states according to the indicator “share from the world export” , Poland, the Czech Republic and Hungary have the highest share. In these countries the share is not influenced by the financial crisis and is related to the development of their national economies and their opportunities to find alternative markets. In the last years the share of Slovakia is extended as well and in Romania. Other countries among the viewed group, like Bulgaria, have relatively sustainable, although not considerable, presence in the world export.

In relation to the import (Figure 4) the trends are similar, as the biggest dynamics, expressed by an increase in the share in the world import, is scored for Poland, the Czech republic and Hungary. Romania and Slovakia are at the second place. In other countries there was some growth especially in Bulgaria but as a whole these countries have insignificant involvement in the world import. From the presented trends it can be seen that the crisis has affected to a different degree the states in the viewed group. Real decrease can be seen in the indicators for Poland, Hungary, Romania, Bulgaria and Latvia, which points to the heterogeneity in the viewed group of countries in respect to their integration in the world trade.

Figure 4

Share of the import of the NMC in world import

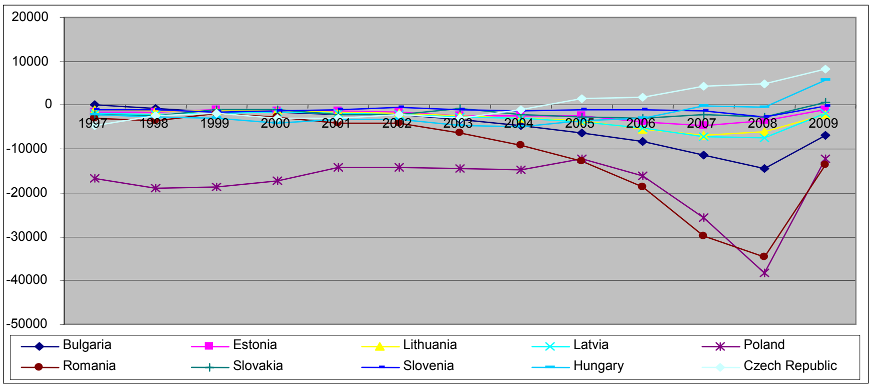


Source. UNCTAD. Handbook of Statistics. UN, New York and Geneva, for corresp. years.

It is important on the base of the showed trends to estimate the reflection of this dynamics on indicators for efficiency – mainly the balance of trade with goods and services. The relatively large period which is covered by international statics and estimates have been made, shows discrepancies in the trade with commodities and with services.

Figure 5

Balance in merchandise trade of the NMC (million USD)

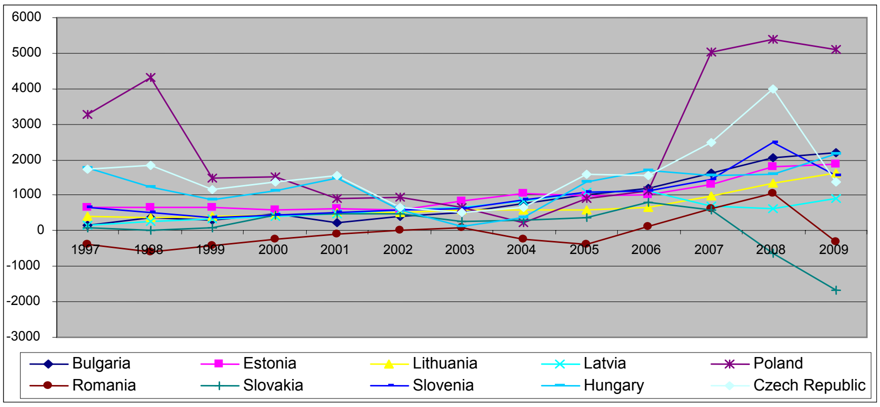


Calculated on International Trade Statistics. WTO, Geneva, 2010, p. 181-194.

Data, presented in Figure 5, shows negative balance in the trade with commodities that is particularly huge and stable for Poland. The trends for Romania also apply to a minor degree to Bulgaria and the Baltic countries - Lithuania, Latvia and Estonia. Most considerable negative balance is in 2008 for Poland and Romania but this refers to Bulgaria as well. The data is relatively stable for Slovenia and Slovakia even though negative. For Hungary the negative balance decreases gradually (it is interesting that in the crisis it becomes even positive). In the Czech Republic the positive balance continues to increase in the last years and together with Hungary the Czech Republic can be qualified as one of the most stable developing countries in the region in the viewed period.

Figure 6

Balance in the trade with commercial services of the NMC



Calculated by International Trade Statistics. WTO, Geneva, 2010, p. 181-194.

Regarding the balance in the trade with services (according to the classification of the World Trade Organization) the data in Figure 6 show positive development (possibly except for Romania despite the positive results observed at the end of the period). Poland, the Czech Republic, Hungary as well as Bulgaria, Slovenia and Estonia are characterized by growing dynamics. Relatively stable are the trends for Slovakia, Latvia and Lithuania. These results are revealing for the better competitive advantages of the NMC in the area of the services - largely information technologies as well as tourism and transport. This can temper the negative data for the balances of trade with commodities, which is largely a consequence from the low competitiveness and the loss of the markets because of dramatic redirection of the trade to the integration processes.

In terms of the influences of the crisis phenomena, there is high sensitivity in the Czech Republic and Slovenia while for Romania, Slovakia and Lithuania the balances turn negative. Sustainability is the trend for Bulgaria, Hungary, Estonia and to a certain degree for Poland which is due to developed sectors from the viewed trade group.

The results of the analysis of the interaction of the newly accepted countries with the world economy in the last years show that due to the transition from central planed to the market economy a considerable opening of their national economies is achieved. The main factor for this is the orientation to binding for the European integration community as the bilateral process – trade liberalization within the agreements on association in the viewed countries and application of the trade standards of the EU.

Redirecting the trade, however, is accompanied with the regional restructuring in the trade flows that did not use the advantages of the existing trade economic relations and worsening trade positions in Russia and post-Soviet space as well as in the Middle East. Due to these the growth of the trade belongs rather to the display of short term static effects of the joining to the integration markets, than the gaining the advantages by the participation of the EU in other regional integration communities.

As a result of the showed factors in the region non-homogeneity in the economic influences and in the world trade is observed. It is developed particularly when the repercussions to the financial economic crises on separate elements of the foreign economic relations are estimated.

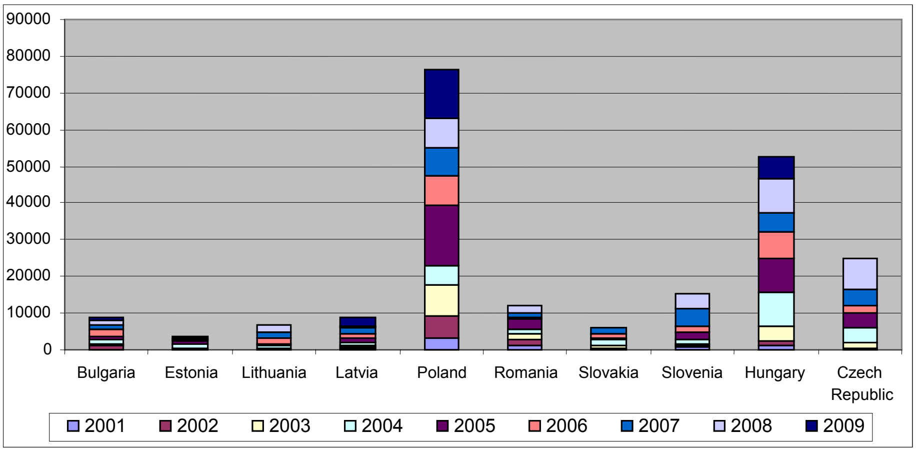
Influence of the Capital Flows on the NMC of the EU

The foreign financing has remained one of the essential factors for the macroeconomic stability of the NMC from CEE in EU. Due to the trends of the development of the foreign economic relations the inflows of capitals help the financial stability in their economies and support structural reforms. The capital flows also reflect the processes in the separate national economies and all the opportunities in every country to attract and utilize efficiently the international financial resources.

The analysis of the status of the international financing reflected in statistics of the international financial institutions shows (see Figure 7), that from the viewed set of countries in the last years Poland has the best indicators followed by Hungary, the Czech Republic - to a minor degree, Slovenia and Romania as well. For the others the volume of foreign financing is relatively small, notably for Estonia, although with different intensity through the specified period.

Figure 7

Foreign financing (bonds, obligations, credits) in the NMC of the EU (millions USD)



Source. International Monetary Fund. Global Financial Stability Report: Responding to the Financial Crisis and Measuring Systemic Risks. Washington, April 2010.

An important indicator for the inflows of capitals is the foreign direct investment (FDI) in NMC. Their presence is determined by the legislative and other regulatory conditions in the individual country and from the policy pursued by the governments in the monitored period. Here the processes of the privatization in some sectors and the involvement of foreign financial institutions in the national economies can also be focused.

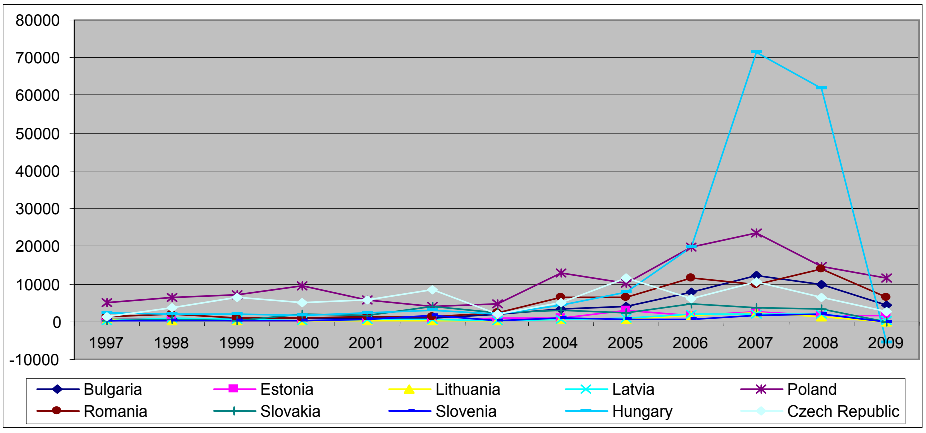
The analysis of the inflows of FDI in the preparation processes of NMC from CEE and during the first years of membership indicates that the most active countries in attracting investments, though not with regular presence are Poland and the Czech Republic and recently Romania and Hungary (see Figure 8). At a lower point of intensity are Bulgaria and Slovakia, and at the lowest levels are FDI in Estonia, Latvia, Lithuania and especially Slovenia.

The revitalization after 2004 is due to the EU accession of these states and the relocation of the production from the old to the new member states contributes to these processes to a certain degree. This is determined by the opportunities to achieve a more competitive performance and a place on the EU Single Market, as well as the extended presence of these countries and their neighbors on the markets in this region. It should be noted that estimations of the researchers indicate that this process was not carried out with the initially expected intensity.[5]

At the same time the influence of the crisis in the last years has changed these positive trends, as major fluctuations are observed in Hungary – sudden inflows and significant decrease in 2009 that is indicative of unsteadiness in the investors' behavior, resulting finally in a lack of financing, and asking IMF for support. There is a crucial drop in investments in Poland, Romania and Bulgaria, which is usual in conditions of problems, encountered by the financial institutions of the countries, being traditional investors in these states.

Figure 8

Inflow of the FDI in the new member countries of the EU



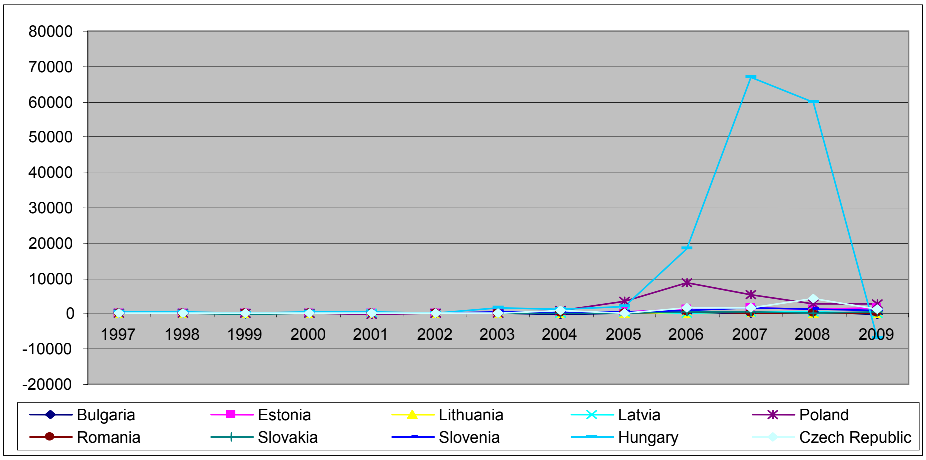
Source. UNCTAD. Handbook of Statistics. UN, New York and Geneva, for correspondent years.

It is also important to estimate the outflows of the FDI from the viewed countries. This is due to the frustration of some investors on the conditions in the given country and due to the change in the strategy of the companies, as a result of the globalization and the exhausted impact by the presence on some markets in the region (see Figure 9).

5 *Inotai, A*. Effects of Accession on the New Member Countries: The Economic Dimension. – In: Avery, G., A. Faber and A. Schmidt (eds.). Enlarging the European Union: Effects on the new member states and the EU Trans European Policy Studies Association. Brussels, 2009, p. 95.

Figure 9

Outflow of FDI from the NMC



Source. UNCTAD, Handbook of Statistic. UN, New York and Geneva, for correspondent years.

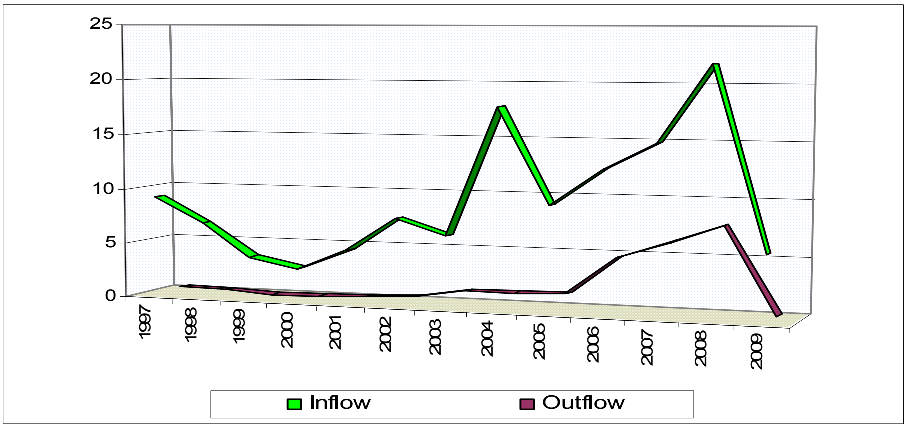
For the first half of the viewed period the outflow was in relatively low levels, from 2005 it was increased particularly in Hungary and to a minor degree in Poland. During the preparation of joining the EU the outflow stepped down abruptly in the two countries and in the Czech Republic, Estonia and Slovenia. One of the factors thereto is the strategy of attracting FDI for these countries. They managed to draw in a large number of foreign companies, offering them special favorable conditions, distinguishing them from the other economic subjects on the national markets. Such a strategy had to be modified after their accession to the Single Market and the introduction of the general competition rules. As a result thereof these companies turned to other regions and the macroeconomic stability of these countries was called into question although they were the most developed from the viewed countries. The fact that the crisis changed the strategy of some major investors in the region should not be underestimated.

Other states have lower rates of outflows of investments, but nevertheless it can become one of the factors impeding the running of the economy especially with regard to the stability of the payment balances.

If comparing the FDI flows in the new and in the old member states, it can be noted that in the last years the relative share of the flow is higher (Figure 10). However their joint share can not be estimated as particularly large (possibly exclusively at the time of the accession), given the low degree of their economic development. Therefore the impact of the financial crisis results in a considerable decrease in the relative FDI share, which makes this part of the European Union considerably more vulnerable to the challenges of the global financial crisis. At the same time the region is characterized by an underdeveloped infrastructure, reducing the competitiveness to a considerably higher extent than the previous EU accession of the less developed states.[6]

Figure 10

Share of the FDI in the NMC compare with EU (%)



Source. UNCTAD. Handbook of Statistics. UN, New York and Geneva, for corresponding year.

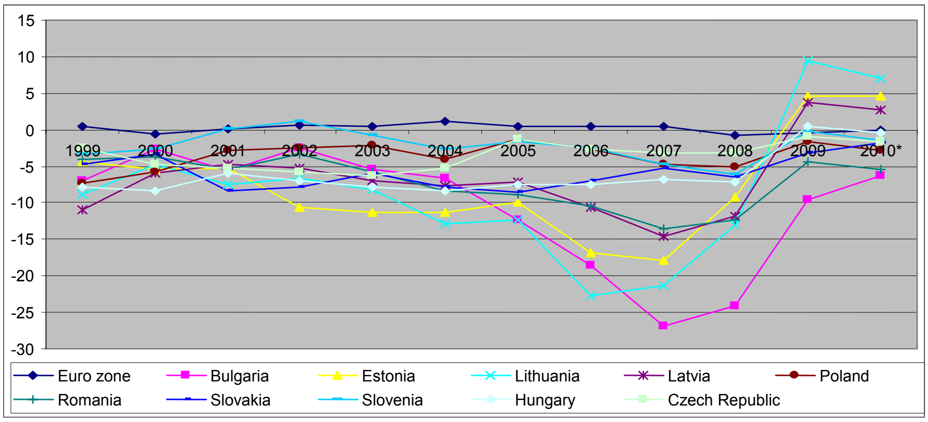
The relative share of outflow is relatively small, but its upward trend is troublesome, which can be taken as an internal competition in the region. The positive fact in this case is, that the share of inflow has been rising, which improves the opportunities for structural reforms and cohesion in the development in these countries with the others in the EU. As a landmark the crisis reduces the attractiveness of their financial systems and the preparation procedures for joining the Euro Zone. It should be noted, that the financial integration[7] degree has risen significantly for Hungary, Estonia, Latvia, Bulgaria and Slovenia, and insignificantly for Romania, matching in many respects the trade trends.[8]

The result of the influence of the foreign financing is presented largely by means of the state of the current account of the balance of payment. In this case the analysis compares the state of the current account of the separate NMC and of the Euro Zone as a whole, considering the fact, that Slovenia and Slovakia have already joined the Euro Zone and Estonia introduced the Euro on 1 January 2011.

[6] See *Inotai, A*. Op. cit., p. 97
[7] Index is calculated from the relations foreign actives and commitment to the GDP.
[8] *Fabrizio, S., D. Leigh, A. Mody*. Op.cit. p. 10.

Figure 11

The state of the current account of the balance of payment of the NMC of the EU



* Preliminary estimate.

Source. International Monetary Fund. World Economic Outlook, Washington, DC, April 2010.

The data presented in Fig. 11, demonstrate the sustainable state of the Euro Zone. Only in the last years negative values were observed. It could be assumed that it corresponds to Slovenia data, being permanently negative and for Slovakia as well. Accession of these countries to the Euro Zone and their separation from the other newly accepted countries is due not to so much to the discrepancies in the economic prerequisites, because it is hard to argue that they differ considerably from the other countries in this group. Rather it is accepted that this is the result of the markedly high political vote of taking the conditions on introducing the Euro and the due broad support from the population.[9] Therefore their contribution to the macroeconomic stability in the newly accepted member countries is in the policy of strict fulfillment of the criteria for membership in the Euro Zone.

From the other data these for the Baltic countries have to be emphasized, that worsen significantly their indicators in the current account, but in the last years after the accession to the European Union take measures to for its essential stabilization and even for its positive state. Relatively sustainable (although with negative values) are the data for Poland, Hungary and the Czech Republic (incl. Slovakia and Slovenia) and for Romania to some extend (despite the decrease in 2006). Bulgaria has the worst indicator, experiencing the biggest difficulties in overcoming this decrease, particularly in 2007 and 2008. Even though in 2009-2010 a recovery was observed in our country, it remains in the lowest position of

[9] *Čihák, M. & W. Fonteyne*. Five Years After: European Union Membership and Macro-Financial Stability in the New Member States. IMF Working Paper N 68, 2009, p. 22.

the group of states and it is indicative for the high vulnerability of the economy under the not restored parameters of the foreign environment following the crisis.

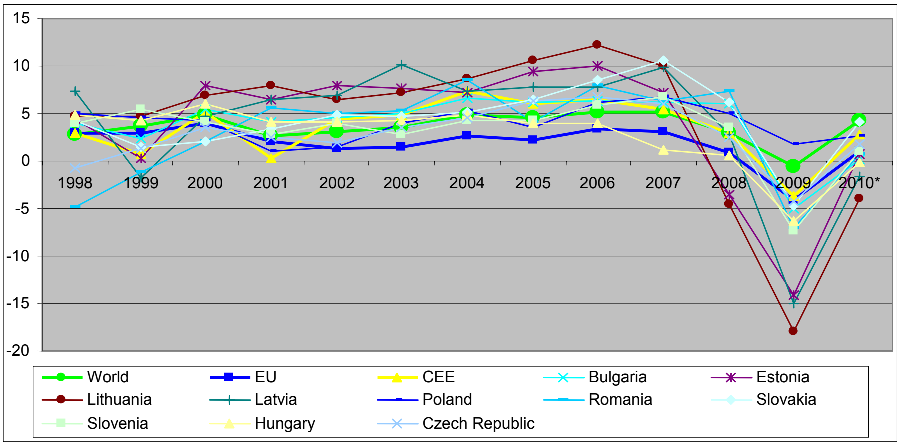
The trends in the dynamics of the GDP can be taken as a general estimate for the influence of the foreign environment. Figure 12 shows the data for the European Union, the CEE region, for all the world, and the position of each newly joined state.

When estimating the regional groups the relatively sustainable state of the GDP dynamics for the world could be pointed out, noting that the European Union and CEE have lower values as a rule, especially due to the reflection of the global crisis in the last years. In the mid period the CEE region scores real higher rates, despite the decrease after the 2007 being under the world average.

In the viewed countries the Baltics have the highest indicators. However the collapse is biggest in 2009. This can be considered the most affected sub-region of the EU. It questions the contribution of these countries to the macroeconomic stability, especially in comparison with Poland, where the decrease is the smallest, even compared to the world average, while the speed of the increase is the most stable. After 2008 the rest of the newly accepted countries worsened their indicators despite the stable rates of growth, even below the rates of the EU and the CEE region. This will slow down significantly the process of recovery. The newly accepted countries proved more sensitive to the outside influences by the world financial crisis. They will search opportunities for harmonizing the integration mechanisms (as far as the general approach of the Union is seen) by national structural reforms and restoration acts of the economic dynamics.

Figure 12

Dynamics of a GDP for the world, EU, CEE and the countries newly accepted in EU (%)



*Preliminary estimate.

Sourse. International Monetary Fund. World Economic Outlook, Washington, DC, April 2010.

So the observed trends testify for regional similarity of the processes when assessing the newly accepted countries. This can be an indicator for the development of the economic relationships in the region. It could also be considered an offsetting reaction against the sensitivity of the viewed set of states compared to the main economic partners among the EU member states.

The specific reflection of the recent financial crisis on the emerging markets is in the change of the viewpoint – from fluctuations on the financial markets to shakeouts of the banking system. Therefore the transfer of the impacts on these economies reflects the nature of their national economic structure and their integration within the world financial system.

Some of the global factors are the state of the world economy - output and growth rates as well as the prices of goods and interest rates. These factors specify the opportunity to follow common approaches in the behavior of the markets, because these countries and regions might have suffered common negative effects due to transfer of the negative effects from one country to another.

The specific impact of the developed economies is characterized by the fluctuations in their economic indicators, their fiscal and trade relations as well as the different opportunities of the national financial markets to influence the economic decisions – trade crediting, reinvesting the profits, money transaction.[10] With the major commitment of the European transition countries with the EU, the liaisons related to financial integration and the common trade increase the opportunity for carrying fluctuations in separate sectors as well as in the financial flows. Regarding the trade - individual sectors of the economies of the newly accepted countries are directly bound, influenced by the demand in the developed EU member states. They cannot find compensation effect in the other countries in the region.

The outflow of fiscal resources in the viewed countries is related to the available variable capital flows, speculative in some cases, as well as with the major engagement of financial institutions of the old member countries (largely banks) in the financial system of the newly accepted countries. Due to this the interaction of the commercial and finances factors in the course of trade crediting has become a crucial kind of transfer of negative consequences on the economy of the newly accepted countries.[11] This is the result of their greater commitment with the west European countries and with the degree of their receptiveness for the Single Market, to some degree - one sided. Therefore the worsening of the general status and the sustainability of the national financial system influence considerably the capital account of their payment balances.

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[10] *Jarociński, M.* Responses to monetary policy shocks in the East and the West of Europe. ECB, Working paper series N 970, November, 2008

[11] World Economic Outlook. IMF, April 2009, p. 145.

The financial crisis suffered in the last few years again puts the question before the newly accepted countries about their stability, about their further adaptation to the conditions of the EU membership and carrying out the full accession to the economic and monetary union. Therefore the regional approach defines also the reduced opportunities for using integration mechanisms for neutralization of the outside influences.

The openness of the countries in focus gives them a chance to feel, although at different degree and direction, the impact of the world crisis in three channels of influence:

- of production – decline in traditional trade partners and limited opportunities to find alternative markets;
- of financing - outflow of capitals and liaison with international financial institutions. Some of the countries in the region with the largest variable capital flows influence like Hungary (6.11.2008), Latvia (23.12.2008), and Romania (4.05.2009) resorted to standby agreements with IMF;
- by the restricted access to financing that is in itself a balancing source of their economic dynamics.

In conditions of looking for the new approaches to overcome some of the shortcomings of the world monetary financial system – the joining of the Euro Zone would hardly be such a stabilizing element, required by the viewed countries. Therefore the stability sources have to be searched in structural reforms that will decrease the residual consequences of their accession to the European Union. The countries should increase their involvement in the external EU activities in the neighbouring regions. Such policies as the Eastern Partnership, the Western Balkans and the Black Sea Synergy will support the inclusion in the integration process, the development of new trade-economic relationships that will strengthen the place of these countries in the European integration community as a prerequisite for using the advantages of the regional cooperation.

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