

MPRA

Munich Personal RePEc Archive

The Coming Golden Age of New Europe

Marcin, Piatkowski

Kozminski University, Warsaw, Poland

01. October 2009

Online at <http://mpra.ub.uni-muenchen.de/19523/>

MPRA Paper No. 19523, posted 22. December 2009 / 11:21



The Coming Golden Age of New Europe

Report No. 26

by Marcin Piatkowski

October 2009

The Coming Golden Age of New Europe

A publication by the Center for European Policy Analysis (CEPA)

October 2009

By Marcin Piatkowski

Marcin Piatkowski, Ph.D. is an Assistant Professor of Economics at TIGER, Kozminski University in Warsaw.

Center for European Policy Analysis
1155 15th Street, NW
Suite 550
Washington, DC 20005
Tel: (202) 551-9200
Fax: (202) 296-3880
E-mail: info@cepa.org
www.cepa.org

© 2009 by the Center for European Policy Analysis, Washington, D.C. All rights reserved. No part of this publication may be used or reproduced in any manner whatsoever without permission in writing from the Center for European Policy Analysis, except in the case of brief quotations embodied in news articles, critical articles, or reviews. The views expressed in the publication are those of the author(s) and do not necessarily reflect the views of the staff, officers or board members of CEPA.

ISBN: 978-0-9825117-5-6

Executive Summary

New Europe has never had it so good. Its income, quality of life and level of happiness have never been closer to that of the developed countries in Western Europe. With its per capita income at an all-time high and the quality of life almost indistinguishable from developed countries, the region is well on its way to achieving a higher level of per capita income than most emerging market countries. New Europe's true Golden Age shimmers on the horizon.

Already a significant global player with a combined GDP about the same size as that of Brazil and Russia, New Europe not only has stronger economic fundamentals, but is also less vulnerable than other emerging markets to political, social and economic Black Swans, catastrophic events that could wipe out much of its economic progress.

The Golden Age, however, will not arrive without an assist from policymakers. The economic crisis has shown that the current growth model based on growing consumption fueled by imported savings has been largely undermined. New models are needed to lessen reliance on domestic consumption in favor of higher exports and stepped-up productivity. To this end, New Europe should enhance incentives for saving, introduce counter-cyclical fiscal policies and increase spending on human capital and innovation. It should also increase labor participation, open borders to immigration and strengthen financial sector supervision. Finally, New Europe should adopt the euro as quickly as possible, at a competitive exchange rate, diversify exports and promote further European Union (EU) integration and enlargement. The crisis provides a good opportunity to implement needed change.

"Once you start thinking about economic growth, it is hard to think about anything else."
Robert Lucas, Jr. 1988

Introduction

New Europe, comprising ten postsocialist new EU member states¹, already a significant global economic player with a combined GDP about the same as that of Brazil and Russia, is likely to be one of this century's fastest growing regions in the world. Unshackled from communism only two decades ago and safeguarded by NATO from military threats, which have undermined its development for hundreds of years, the region has never before been better positioned to increase its per capita income and expand global importance. Thanks to low income inequality and adoption of the European way of life, emphasizing cultural and social development almost as much as an economic one, the quality of life and level of happiness are likely to improve as well. Given that New Europe's level of per capita income today relative to Western Europe is at its highest level since 1500 and that it has extraordinary growth prospects, the 21st Century Golden Age is inevitable.

This prediction may sound bold when the region has entered its deepest crisis since the beginning of its transition. GDP growth in New Europe will be negative this year; next year will not be much better. But the underlying long-term strengths of the region – with political, ethnic and religious stability, educated population, low income inequalities, inflow of EU money, rule of law, adoption of the euro and further integration with Western Europe – will not be undermined because of the crisis.

The ongoing integration within the EU in particular will continue to benefit the region due to higher investment, increased trade and enhanced labor mobility. EU integration will also increasingly narrow the margin for bad policymaking, which in the long run can offset even the most advantageous economic fundamentals and lead to economic reversals undermining decades of progress. The last decade has shown that the institutional straitjacket and EU-supervised rule of law made even the most populist governments in the Central and Eastern Europe (CEE) region largely impotent.

The same cannot be said about most other emerging markets economies, where---if the last 40 years are any indication--the next 40 years should see a fair share of political, social and economic turbulence, including wars, political coups, ethnic violence and terrorism. These events could substantially wipe out economic progress. The probability of political and economic reversals, equivalent to rare but catastrophic

¹ Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia. The name of New Europe is used here instead of Eastern Europe, because the latter is not geographically correct (most new EU member states are located in Central Europe) and because it has negative connotations.

economic crises, is far from zero. The current crisis provides a classic example of an unexpected, large and disastrous event that is likely to compromise economic progress achieved in recent years.

Despite strong fundamentals, New Europe's development needs to be supported by good economic policymaking, which is an indispensable ingredient of long-term growth. As argued by Lin (2009), in the long-term the quality of economic policymaking is more important than geographical location, natural endowments or even the quality of institutions, particularly as the latter is dependent on policymaking.²

The crisis revealed that New Europe's current development model based on an excessive reliance on foreign capital flows, foreign owned banking systems and undiversified exports, mostly to other countries in the EU, has been largely undermined. New kinds of policymaking and models, based on creative combinations of the best characteristics of the New European and Asian growth models will be needed to reach parity with more developed countries.

This paper is organized as follows: chapter II documents New Europe's increase of GDP per capita to its highest level relative to Western Europe since 1500. Chapter III discusses the impact of the global crisis on New Europe's economies. Chapter IV takes a long-term perspective and argues that by 2050 New Europe is likely to have grown more than most emerging market economies and will have achieved per capita income practically equal to that in Western Europe. Chapter V provides conclusions and recommendations.

The last 2000 years

Maddison (2003) provides data on long-term per capita levels between 1500 and 1998. Table 1 shows that Eastern Europe, which includes Albania, Bulgaria, former Czechoslovakia, Poland, Romania and countries of former Yugoslavia, achieved the highest level of per capita income of around 60 percent of Western Europe's per capita income in 1500. Since then, the level of per capita income in Eastern Europe relative to Western Europe has been declining, reaching its lowest level of 30 percent in 1998.³

² Lin (2009) adds that economic policymaking is in turn often a function of prevailing economic, social and cultural ideas, although these can also change in longer time horizons.

³ Of course, historical comparisons of levels of income have large margins of error. Yet, they still provide a useful picture of levels of development, confirmed by anecdotal evidence collected in the large literature on the subject.

Table 1. Per capita GDP in Eastern Europe 1500-1998, Western Europe = 100

	1500	1600	1700	1820	1870	1913	1950	1973	1998
Western Europe	100	100	100	100	100	100	100	100	100
Eastern Europe	60	58	55	52	44	44	46	43	30
Former Soviet Union	65	62	60	56	48	43	62	53	22
USA	52	45	51	102	124	153	208	145	153
Latin America	54	49	52	54	35	44	56	39	32
China	78	67	59	49	27	16	10	7	17
India	71	62	54	43	27	19	13	7	10
Japan	65	58	56	54	37	40	42	99	114
Other Asia	73	63	55	46	31	23	20	18	21
Africa	52	45	39	34	22	17	19	12	8

Notes: Eastern Europe (EE) includes Albania, Bulgaria, Czechoslovakia, Poland, Romania and former Yugoslavia.

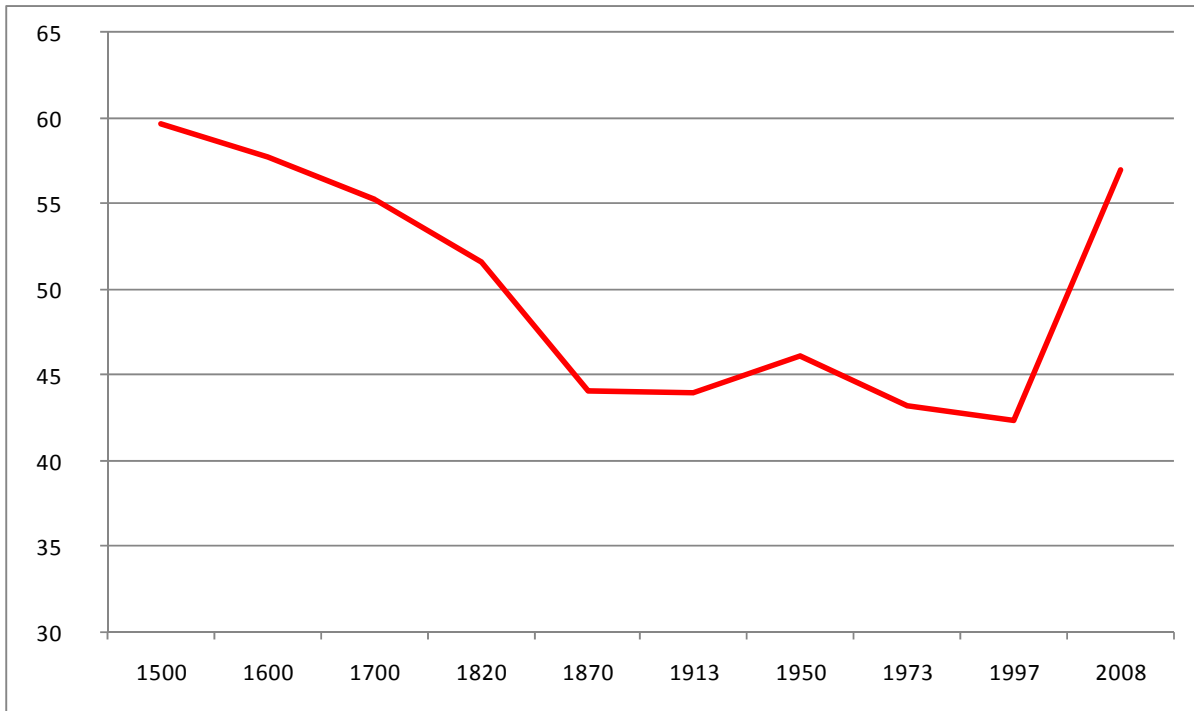
Source: author's calculations based on Maddison (2003)

Since the beginning of 1990's, however, after long centuries of deconvergence, Eastern Europe's income, as measured for ten postsocialist new EU member states, has experienced a huge reversal. In 2008, per capita income in New Europe relative to Western Europe achieved roughly the same level as in 1500, the highest in more than 500 years (Figure 1).⁴ Assuming that between year 0 and 1000, the relative income per capita was not higher, last year New Europe achieved the highest absolute and relative level of material well-being in its history.⁵

⁴ Maddison and Eurostat data are not fully comparable because of the different sample of countries and different PPS measures. However, while exact levels of income would be different according to both measures, the trends would still be similar.

⁵ Because of lack of data, Maddison (2003) assumes that the level of per capita income in Eastern and Western Europe in year 0 and 1000 was the same. However, taking into account lower population density, lower trade and generally a lower level of social and political development, it seems reasonable to assume that New Europe's level of income was significantly lower than in Western Europe.

Figure 1: Per capita GDP in New Europe, 1500-2008, Western Europe = 100

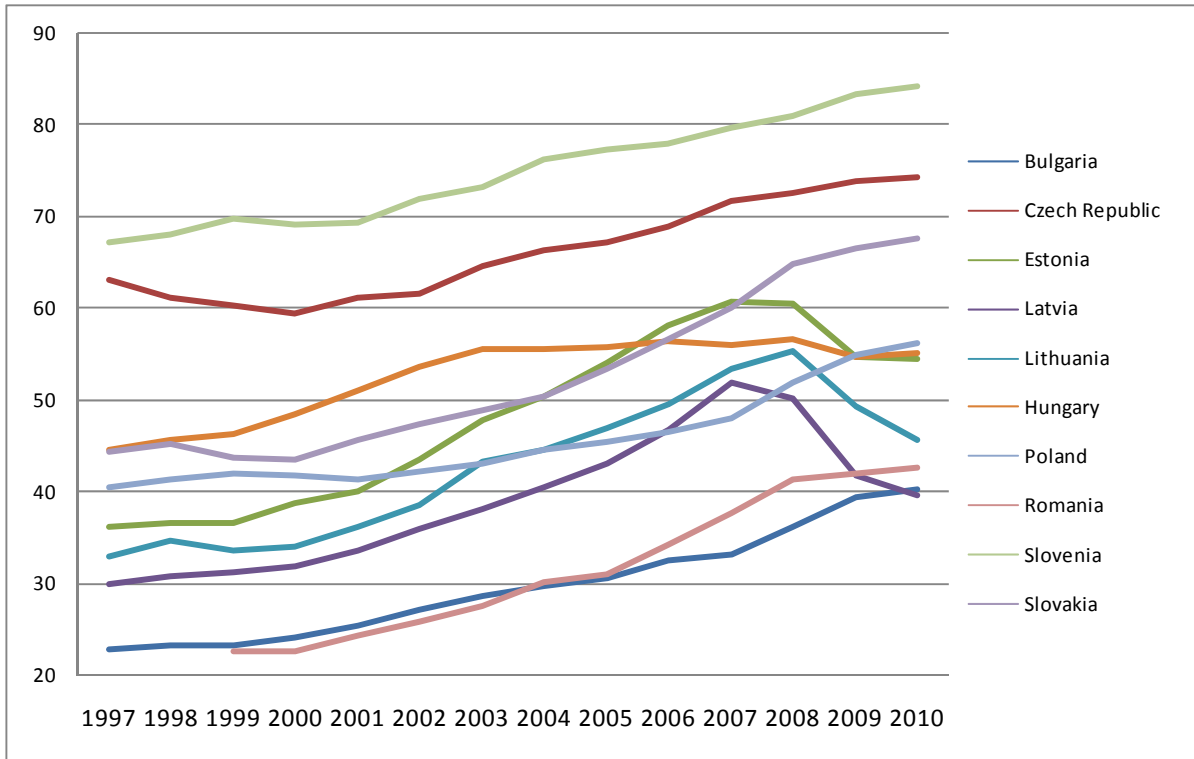


Source: Maddison (2003) for 1500-1973 and Eurostat data for EU-10 relative to EU-15 for 1997-2008.

Note: EE in Maddison includes Albania, Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and Yugoslavia. Maddison data are in 1990 international \$, while Eurostat in PPS. Both unweighted averages.

The reversal in growth, particularly since 1997, was of truly historical proportions. New European countries have never been catching up so quickly with Western Europe and never all of them at the same time (Figure 2). The weighted average of New Europe's per capita GDP increased from 40 percent in 1999 to 52 percent in 2008. The income convergence is likely to continue during 2009-2010, although not for the Baltic States, whose relative income level, because of the crisis, will decline substantially.

Figure 2: Per capita GDP in New Europe 1997-2010, EU-15 = 100, PPS

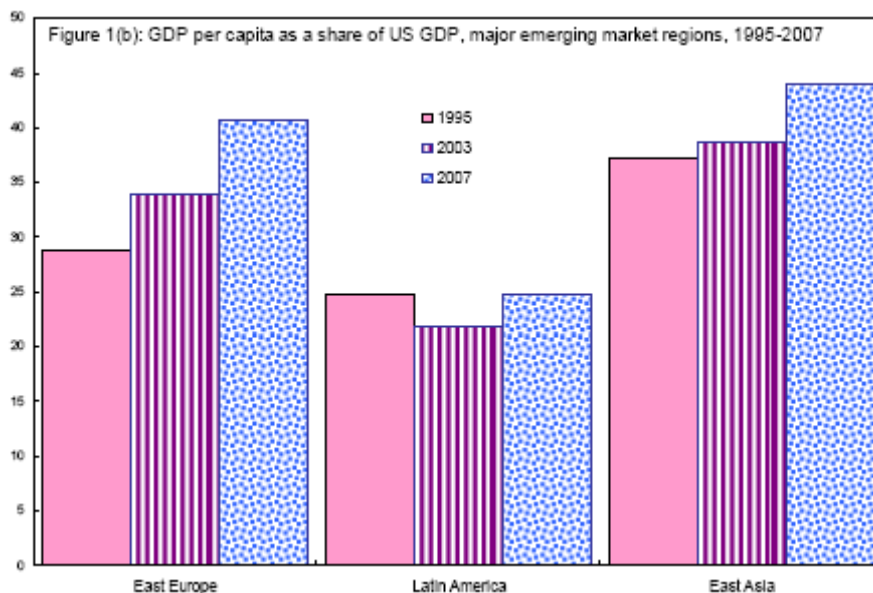


Source: Eurostat and European Commission spring 2009 projections for 2009-2010.

Such explosive convergence during the last decade was largely due to the positive effects of EU integration, culminating in two waves of eastern enlargement in 2004 and 2007. According to the report of the European Commission (2009) analyzing the economic effects of EU enlargement after five years, New European countries' annual growth rate between 2000 and 2008 accelerated by a significant 1.75 percentage points. Similarly, Cihak and Fonteyne (2009) assess that EU accession has increased New Europe's growth by one percentage point a year.

New Europe has also performed impressively relative to the emerging markets in East Asia and Latin America. Average per capita income ratio in New Europe relative to the U.S. increased from 29 percent in 1995 to 41 percent in 2007, or 12 percentage points. East Asian income has increased by only seven percentage points, while that of Latin America has hardly grown at all, although there were large differences in economic performance among individual countries (Figure 3).

Figure 3: Per capita GDP in New Europe, East Asia and Latin America relative to the U.S., 1995-2007, PPS



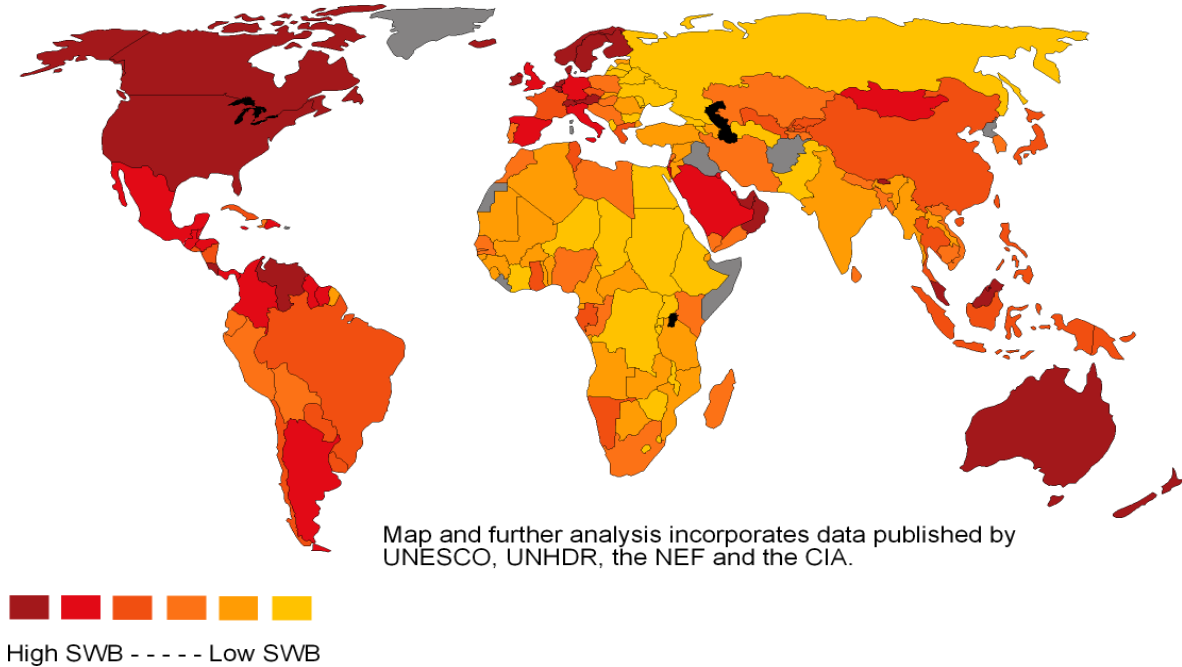
Source: Fabrizio et al. (2009) based on IMF data.

However, growth in per capita GDP does not fully depict improvements. New Europeans today enjoy historically unparalleled quality of life, which lags behind Western Europe much less than what differences in income levels would suggest. Thanks to the Internet, open borders and flattening of the world's economy, New Europeans today enjoy the fruits of global technological, cultural and social development almost as much as Western Europeans.

The level of happiness in New Europe is also at an all time high, rising from historical lows in the last years of socialism (Layard, 2003, Eurofund, 2009). The United Nations Development Programme's (UNDP) Human Development Index, combining per capita GDP, educational achievement and life expectancy is also at a historical high. It is also much higher than what the level of income alone would suggest. Kolodko's (2010) "Integrated Index of Welfare," comprising such factors as GDP, education, availability of free time and the quality of natural environment, would also be at its peak. The Leicester University map of world's subjective well-being suggests that New Europeans as a whole are quite satisfied relative to other regions of the world, including Latin America and Asia (Figure 4).

Figure 4: Global projection of subjective well-being (SWB), 2006

A Global Projection of Subjective Well-being



Source: White (2007)

The Crisis

The imported global crisis has hit New Europe hard, and the magnitude was largely unexpected.⁶ This year most economies of the region will shrink for the first time since the beginning of transition: by the end of the year, Baltic economies' GDP will be more than 10 percent smaller; Poland's GDP, the region's star performer, will grow by only 1 percent. In 2010, growth in most countries in the region will be only slightly positive, although the most recent data point to some upside potential; Baltic States' GDP is projected to continue to shrink (Table 2). Despite lower growth rates, however, the convergence process for most of these countries will continue, because Western European countries are expected to grow even slower. Countries like Poland, which are doing relatively well during the crisis, will---paradoxically--converge with Western Europe even faster than before the crisis.

⁶ In mid-2008 the IMF, European Commission and the World Bank still projected positive growth rates in most countries in the region for 2009.

Table 2. GDP growth in New Europe and the euro zone, 2002-2010

	2002-2006	2007	2008	2009	2010
Bulgaria	5,7	6,2	6,0	-1,6	-0,1
Czech Rep.	4,6	6,0	3,2	-2,7	0,3
Estonia	8,4	6,3	-3,6	-10,3	-0,8
Latvia	9,0	10,0	-4,6	-13,1	-3,2
Lithuania	8,0	8,9	3,0	-11,0	-4,7
Hungary	4,3	1,1	0,5	-6,3	-0,3
Poland	4,1	6,6	4,9	-1,4	0,8
Romania	6,2	6,2	7,1	-4,0	0,8
Slovenia	4,3	6,8	3,5	-3,4	0,7
Slovakia	5,9	10,4	6,4	-2,6	0,7
Euro zone	1,7	2,7	0,8	-4,0	-0,1

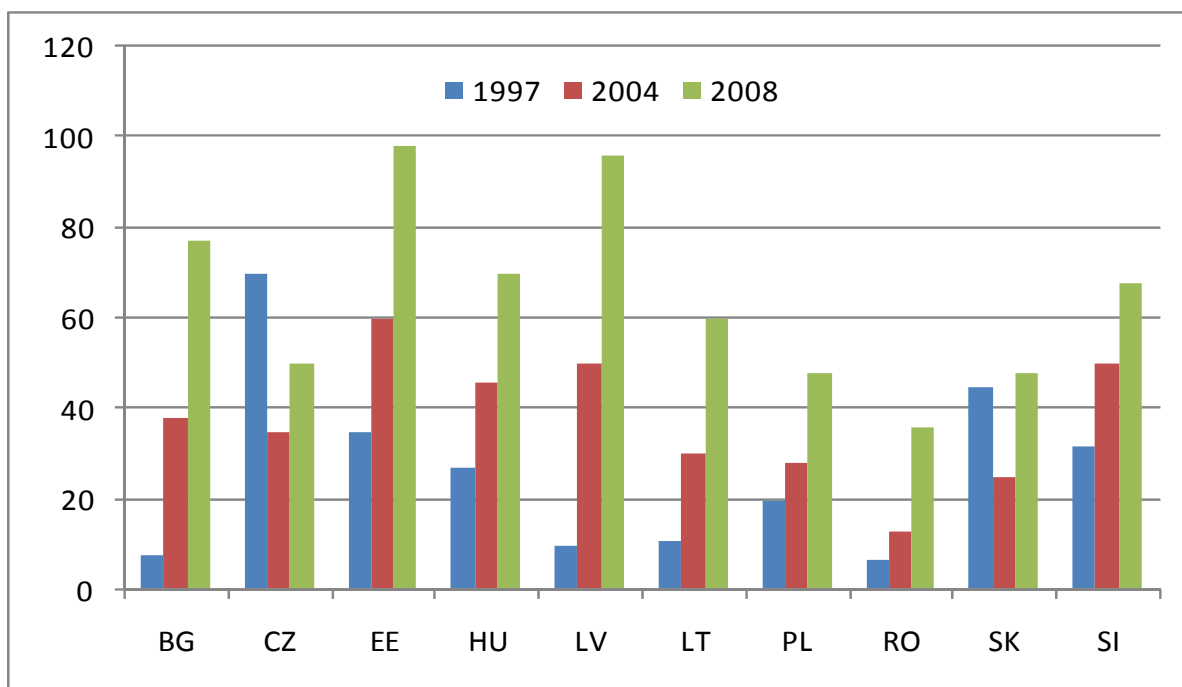
Source: European Commission, including April projections for 2009-2010.

Baltic States in particular are vulnerable to the imported crisis because they have allowed an unprecedented increase in external imbalances and build-up of large speculative bubbles in real estate markets. Until recently, current account deficits in Baltic States exceeded 20 percent of GDP; the deficits were only marginally smaller in Bulgaria and Romania. Only Poland, the Czech Republic, Hungary, Slovakia and Slovenia reported deficits below 10 percent of GDP, a threshold usually indicating the danger zone. All New European countries had wider external imbalances than most other emerging markets, especially Eastern Asia (Cihak, Fonteyne 2009). Real estate bubbles were also unprecedented – during 2004-2007 real estate prices in Riga more than tripled, exceeding levels in some Western European capitals, despite the level of per capita income at only half the EU-15 average (Global Property Guide, 2009).⁷

Such large external imbalances and asset bubbles resulted mainly from a supercharged increase in credit. Figure 5 shows that in all countries of the region the share of credit in GDP has multiplied several times in the past decade, with Latvia's credit ratio increasing by almost ten times.

⁷ Since the peak in mid-2007, real estate prices in Latvia, Riga have more than halved.

Figure 5: Total bank credit to the non-financial private sector in New Europe, 1997-2008

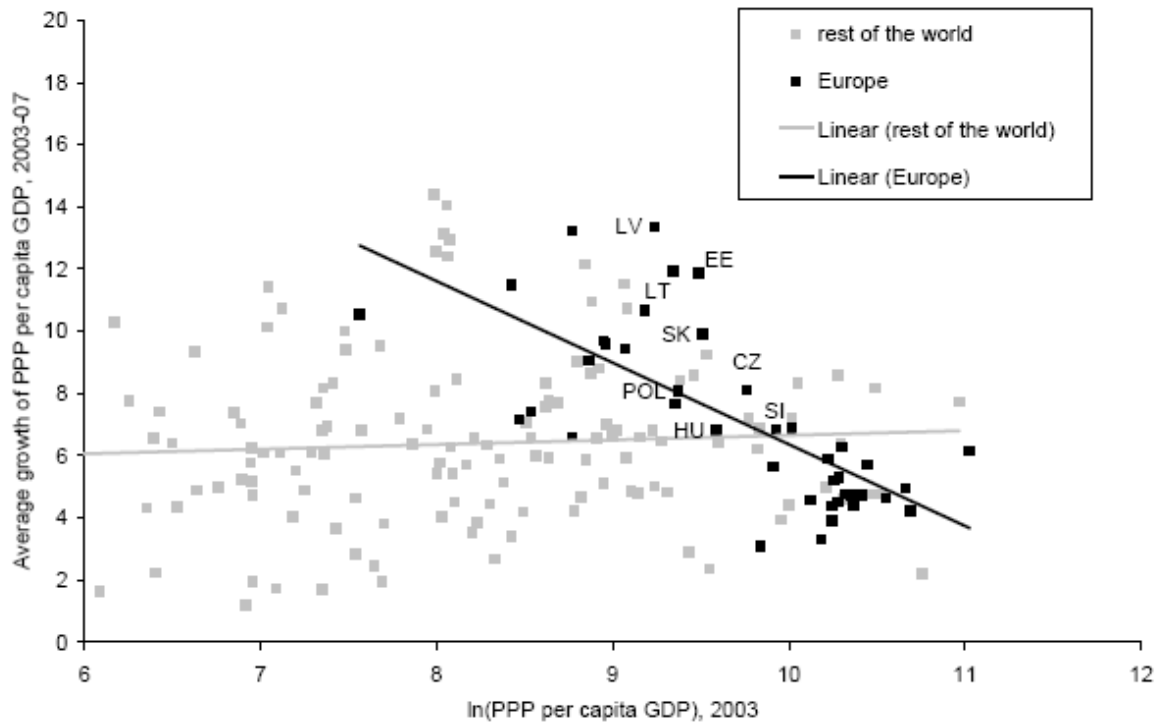


Note: 2008 data as of October.
 Source: Keereman et al. (2009) based on the IMF.

Such rapid downturn was fueled by foreign currency lending from Western European banks, which control more than 60 percent of the region’s banking sector assets, as opposed to only 30 percent in the old EU member states and around 20 percent in the rest of the world (Cihak and Fonteyne, 2009). The banking sector in Estonia, Latvia, Lithuania and Slovakia is totally foreign-owned. During 2004-2008, the share of foreign financing in GDP in most countries of the region has more than doubled; in Latvia, the share of foreign financing in GDP increased from 18 percent in 2004 to 70 percent only four years later (Keereman et al, 2009).

The crisis seems to have segmented New European countries into three groups: the first includes Poland, the Czech Republic and Slovenia, which have grown slower than the rest but are now less affected by the crisis; the second group includes the Baltic States which have grown at almost Chinese rates in the recent past but are now suffering; and the third group, including Slovakia, Romania and Bulgaria, which are somewhere in the middle.

Figure 6: Convergence in New Europe and the rest of the world, 2003-2007



Source: Cihak and Fonteyne (2009).

The strong impact of the global crisis on New Europe will surely have implications for development in subsequent decades. The current development model based on rapid credit growth, wide external imbalances, real estate and stock market bubbles and foreign-owned banking sectors seems to have largely failed. Reliance on exports to euro zone, global speculative capital and industrial monocultures, especially in the automotive industry, has also been called into question. New development models will be needed to ensure continued convergence in the future.

The next 40 years

One thing is certain: the crisis will end.⁸ When it does, there are reasons to believe that rapid growth in New Europe will resume, although probably at a lower rate than

⁸ New Europe is already adjusting to the new world of dried-up foreign financing through—as should be expected—a sharp correction in external imbalances. This is being achieved through currency depreciations and/or drops in domestic demand. Latvia’s current account deficit improved from -25 percent of GDP in mid-2007 to -13 percent in Q4 2008. Bulgaria’s CA deficit decreased from -27 percent of GDP in Q2 2008 to below -20 percent of GDP in Q1 2009. Countries with floating exchange rates –

before. Catching up is likely to continue, with countries in New Europe growing at a rate of at least one percent higher than in Western Europe. As a result, by 2050 most countries of New Europe will have achieved per capita incomes close or equal to that in Western Europe.

There are a number of long-term growth projections for New Europe. PriceWaterhouseCoopers (PWC, 2008) provides projections of GDP growth until 2050 for 30 economies accounting for 85 percent of the world economy, including Poland, which we can use as the proxy for New Europe. According to these projections, based on an extrapolation of historical trends in capital investment, anticipated changes in the quality and size of the labor force, and assumed productivity growth rates, Poland's per capita GDP will grow by 2.7 percent a year until 2050. It appears substantial, but is much below the growth rates for all other emerging markets and only 0.8 percent higher than the G-7 average (Table 3). PriceWaterhouseCoopers explains that Poland's low projected per capita growth rate reflects less favorable demographics and a rapidly aging population over the period.

Table 3. Projected real growth rates in selected emerging markets, 2007-50

	GDP in US\$	Population	GDP per capita at PPPs
Vietnam	9,8	0,8	6,0
India	8,5	0,8	5,0
Nigeria	8,0	1,6	4,4
Phillippines	7,2	1,1	4,1
Egypt	7,1	1,1	3,9
Bangladesh	7,0	1,1	3,9
China	6,8	0,1	4,6
Indonesia	6,7	0,6	3,9
Pakistan	6,4	1,4	3,5
E7 average	6,4	0,5	4,0
Malaysia	5,8	1,0	3,3
Thailand	5,7	0,1	3,5
Iran	5,2	0,8	3,0
Brazil	5,2	0,7	3,1
Turkey	5,1	0,7	3,4
Argentina	4,9	0,6	3,0
South Africa	4,8	0,3	3,3
Saudi Arabia	4,8	1,4	2,7
Mexico	4,7	0,5	3,2
Russia	4,3	-0,6	3,2
Poland	3,4	-0,5	2,7
G7 average	2,0	0,3	1,9

Source: PWC (2008).

Romania, Poland, Czech Republic and Hungary – witnessed substantial decreases in the value of their currency, improving export competitiveness.

Growth projections for most emerging markets are quite optimistic. For instance, the projected growth in per capita GDP for Nigeria and Argentina of 4.4 percent and 3.0 percent a year, respectively, seems high given the two countries' projected fast population growth, chronic political instability and history of sub-par growth. On the whole, PWC projections seem to be either too pessimistic for Poland (and – by proxy – for New Europe) or too optimistic for other countries, perhaps because they do not take into account political risks discussed later in this section.

Carone et al. (2006) long-term GDP growth and labor productivity projections for EU-25 are only slightly more optimistic than those of PWC.⁹ They project that EU-10 per capita GDP (excludes Bulgaria and Romania, but includes Malta and Cyprus) during 2004-2050 would grow at 2.6 percent a year, one percentage point above EU-15 (Table 4).

Table 4: Projected GDP per capita growth rates of EU-25, 2004-2050

	2004-2010	2011-2020	2021-2030	2031-2040	2041-2050	2004-2050
BE	2.1	1.8	1.2	1.5	1.7	1.6
DK	1.8	1.8	1.2	1.3	2.0	1.6
DE	1.6	1.7	1.1	1.4	1.6	1.5
GR	2.6	1.8	1.3	1.0	1.2	1.5
ES	2.0	2.3	1.5	0.8	1.0	1.5
FR	1.7	1.6	1.5	1.5	1.7	1.6
IE	4.2	3.1	1.9	1.3	1.1	2.2
IT	1.6	1.8	1.4	1.0	1.5	1.5
LU	3.0	2.1	2.0	2.3	2.4	2.3
NL	1.3	1.5	1.2	1.5	1.9	1.5
AT	1.9	1.9	1.1	1.3	1.5	1.5
PT	1.5	2.3	2.0	1.1	1.2	1.6
FI	2.4	1.7	1.5	1.7	1.7	1.8
SE	2.3	2.3	1.7	1.6	1.8	1.9
UK	2.4	2.2	1.4	1.5	1.6	1.8
CY	2.9	3.1	2.3	2.0	1.3	2.3
CZ	3.6	3.2	2.5	1.4	1.1	2.3
EE	6.6	4.2	2.8	2.0	1.2	3.1
HU	3.9	3.1	2.6	1.4	1.3	2.4
LT	7.0	4.8	2.5	1.7	1.2	3.2
LV	8.3	5.0	2.8	1.9	1.0	3.5
MT	1.3	2.0	2.4	1.9	1.4	1.8
PL	4.7	4.0	2.9	1.6	1.0	2.7
SK	4.7	4.3	2.8	1.3	0.8	2.7
SI	3.6	2.8	2.2	1.5	1.3	2.2
EU25	2.2	2.1	1.6	1.4	1.5	1.7
EU15	1.9	1.9	1.4	1.3	1.6	1.6
EU12	1.8	1.8	1.4	1.3	1.5	1.5
EU10	4.6	3.8	2.7	1.5	1.1	2.6

Source: Carone et al. (2006)

Interestingly, Carone et al. (2006) project that owing to less favorable demographic projections and slower productivity growth rates, New Europe's convergence with EU-15 would decelerate in 2031-2040 and then reverse during 2041-2050. As a result, in 2050

⁹ In the production function approach, "projected productivity is the outcome of an extrapolation of recent trends; of an assessment of the medium-run effects of demographics on capital deepening; and of some long-run convergence assumptions regarding TFP (i.e. a return to the long-term historical average for the period 1970-2005)." (Carone et al. 2006).

EU-10 per capita GDP will reach 78 percent of EU-15 level (Table 5), down from 82 percent in 2040.

Table 5: Projected per capita GDP levels of New Europe relative to EU-15, 2004 – 2050

	2004	2010	2030	2040	2050
BE	108	109	106	108	109
DK	110	110	107	107	111
DE	101	99	94	95	95
GR	72	74	72	70	68
ES	85	86	90	86	81
FR	105	104	101	103	103
IE	132	150	177	176	167
IT	100	98	97	94	94
LU	194	207	225	247	268
NL	108	105	98	100	103
AT	116	117	113	113	112
PT	68	66	73	71	68
FI	108	111	110	114	115
SE	112	115	123	126	129
UK	104	107	111	112	113
CY	81	87	107	113	110
CZ	64	71	89	90	86
EE	46	60	86	91	87
HU	54	60	76	77	75
LT	43	58	86	89	87
LV	42	60	93	99	94
MT	68	65	73	77	76
PL	45	53	75	77	73
SK	48	57	83	83	77
SI	73	80	94	96	94
EU25	92	93	97	97	97
EU15	100	100	100	100	100
EU12	99	98	97	97	96
EU10	50	59	80	82	78

Source: Carone et al. (2006)

Poncet (2006) provides another source of long-term growth projections including a number of New European economies. By 2050, Poland, Czech Republic, Hungary and Romania are expected to grow at an annual rate of 1.5-1.8 percent.¹⁰ This is much below projected growth rates for most other emerging markets. For instance, Malaysia, the Philippines and Pakistan are expected to grow at a rate exceeding five percent a year. Surprisingly, even some developed countries such as the U.K., Canada, Netherlands and Sweden, are projected to grow faster than New European economies.

¹⁰ Poncet also provides estimates of growth until 2020: Poland would grow at 2.4 percent and the Czech Republic at 2.5 percent a year.

Table 6: Projections of real GDP growth and per capita GDP at current US\$ in 2050

	GDP per capita 2050 (in US\$)	GDP growth (%)
Philippines	21665	6,1
Malaysia	53902	5,5
Pakistan	2373	5,0
China	22177	4,6
Thailand	31115	4,6
India	4417	4,5
Indonesia	6616	4,5
South Korea	147897	4,1
Bangladesh	1163	3,4
Singapore	129479	3,3
Iran	3572	3,0
Ireland	76113	2,9
USA	93323	2,8
Peru	3759	2,7
Egypt	2285	2,6
Netherlands	57013	2,3
UK	57970	2,1
Finland	63570	2,1
Sweden	67111	2,0
Turkey	4747	1,9
Colombia	1830	1,9
Poland	14684	1,8
Argentina	7407	1,8
Greece	35732	1,8
Romania	8241	1,8
Chile	5803	1,8
Germany	48537	1,7
Mexico	5860	1,7
Portugal	25667	1,7
Czech Rep.	15978	1,7
France	39701	1,6
Spain	32324	1,6
South Africa	5629	1,6
Japan	88747	1,5
Hungary	15479	1,5

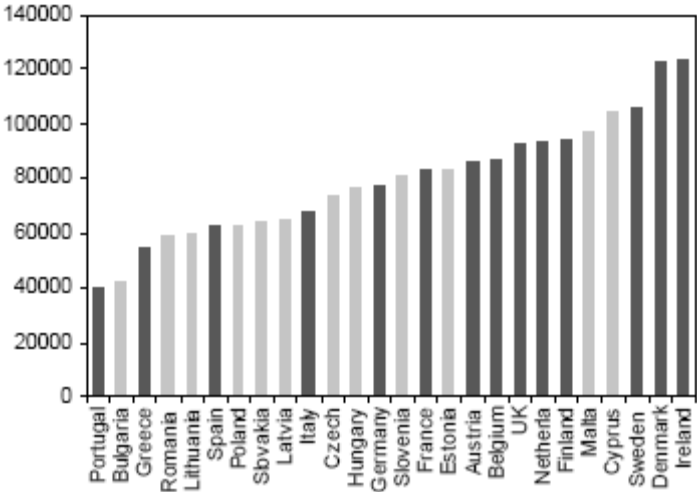
Source: Poncet (2006)

Goldman Sachs, an investment bank which evaluated Brazil, Russia, India and China (BRICs) in its 2003 report (Wilson and Purushothaman, 2003), in 2007 expanded its analysis beyond BRICs to include “N-11,” the next 11 countries with significant growth potential. Strangely, no New European countries were included (Goldman Sachs, 2007).¹¹ Poland was used only as a yardstick for comparison, which in 2050 would have

¹¹ Deutsche Bank projections (Bergheim, 2005) for 34 world economies until 2020 do not include any countries from New Europe, either.

a smaller economy than that of Egypt, the Philippines, Vietnam and Bangladesh. This implies a substantially lower projected growth for Poland in future decades, given that Poland’s GDP is today three times as big as that of Bangladesh.¹² A year later, however, Goldman Sachs has become more optimistic about New Europe, projecting that by 2030 New Europe should grow by at least two percentage points per year faster than EU-15 (Zsoldos and Zadornova, 2008). By 2050, New Europe’s level of income would only be 10-15 percent lower than in EU-15, with some New European countries being among the wealthiest in the whole EU (Figure 7).

Figure 7: Per capita income in New Europe and EU-15 in 2050, in 2007 US\$



Source: Zsoldos and Zadornova (2008)

Rapacki and Prochniak (2009) are more optimistic on the time needed for New Europe to converge with Western Europe. If, in the future, New Europe’s growth rates were equal to the 1997-2010 average, all New European countries would fully converge with the EU-15 within the next 30 years; that is, by 2038 in the case of the poorest Bulgaria (Table 7). Even with less optimistic growth assumptions, New Europe is likely to be close to the EU-15 level of per capita income by 2050.

¹² According to the IMF, as of the end of 2008 Poland’s GDP in PPP amounted to \$669 billion, while that of Egypt, the Philippines, Vietnam and Bangladesh amounted to only \$447, \$320, \$240 and \$227 billion, respectively.

Table 7: Possible scenarios of closing the income gap between New Europe and EU-15

Country	GDP per capita (PPP, % of EU-15 average in 2008)	Average annual GDP growth (1997-2008 and forecast for 2009-10)	Expected time in years to catch-up with the EU-15 average	Year of reaching the EU-15 average
Bulgaria	35,6	5,1	30	2038
Czech Rep.	73,9	3,2	19	2027
Estonia	61	6,2	11	2019
Hungary	56,4	3,6	28	2036
Latvia	50,4	6,8	14	2022
Lithuania	55,6	6,2	13	2021
Poland	50,1	4,3	26	2034
Romania	38,5	6,2	20	2028
Slovakia	64	5,1	13	2021
Slovenia	82,4	4,1	8	2016
EU-15	100	1,6	n.a.	n.a.

Source: Rapacki and Prochniak (2009)

By 2050, New Europe is likely to have reached the Western level of income, as well as grown faster than most other emerging markets, the rather pessimistic projections cited above notwithstanding. There are a number of reasons why this is likely to be the case.

1. **Institutions are stronger in New Europe than in most emerging markets.**¹³ Table 8 shows that the quality of New Europe's institutions, reflected in three rankings done by the World Bank, Heritage Foundation and Transparency International, is much higher than in other emerging markets. Table 8 also shows that the quality of institutions in New Europe has been improving faster than elsewhere, mostly thanks to EU integration. This trend is likely to continue until New Europe's quality of institutions reaches Western European levels.

¹³ See North (1993) and Kolodko (2000) for arguments on why high-quality institutions are indispensable for fast long-term growth.

Table 8: Quality of institutions in New Europe and other emerging markets

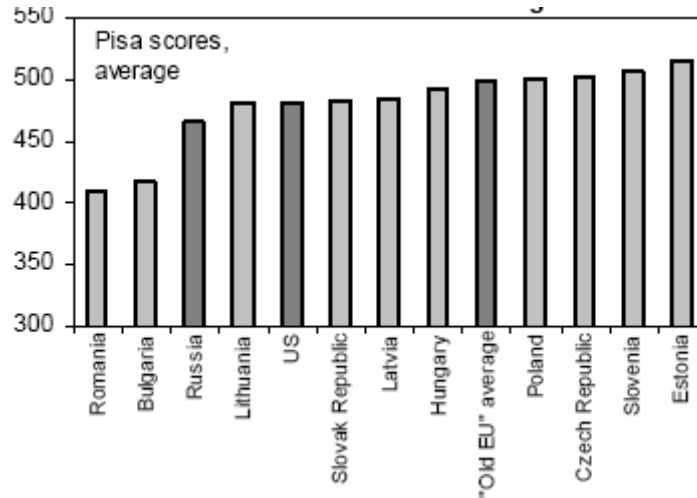
		New Europe	Other emerging markets
Rank in Ease of Doing Business (World Bank)	2006	44,4	65,3
	2009	42,8	68,3
Index of Economic Freedom (Heritage Foundation)	1999	60,6	64,5
	2008	66,9	63,7
Corruption Perception Index (Transparency International)	1999	4,3	4,4
	2007	5,0	4,4

Note: Ease of Doing Business: the lower, the more favorable. Index of Economic Freedom (from 0 to 100): the higher, the better; Corruption Perception Index (between 0 and 10): the higher, the less corruption. "Other emerging markets:" 16 countries with an income level similar to that in New Europe: Argentina, Botswana, Chile, Costa Rica, Croatia, Lebanon, Malaysia, Mauritius, Mexico, Oman, Panama, Palau, South Africa, Turkey, Uruguay and Venezuela.

Source: Keereman et al. (2009) based on World Bank, Heritage Foundation and Transparency International.

- 2. The quantity and quality of education in New Europe is higher than in most emerging markets** and even in some developed countries. Both quantity and quality of education have been improving at an extraordinary rate in the last 20 years. In 2008, the tertiary scholarization ratio, measuring the proportion of young adults aged 18-24 enrolled in tertiary education, reached almost 50 percent in New Europe. This was only slightly below the old EU member average of 60 percent, but above Latin American and Chinese ratio of only 30 percent and 20 percent, respectively. The quality of education in New Europe is also high: According to the latest 2006 Organization for Economic Co-operation and Development (OECD) (2006) PISA study, measuring the science, reading and mathematics performance of 15 year olds in 57 countries around the world, New European countries scored above what would be suggested by their per capita income. In the ranking on performance in science, for instance, Estonia was in 5th place, Slovenia in 12th place and the Czech Republic in 15th place. Other emerging markets scored much lower, with Russia ranked 35th, Thailand 46th, Mexico 49th and Brazil 52nd. Results for reading and mathematics performance exhibited similar patterns. In the ranking on the combined PISA scores, Estonia, Slovenia, Czech Republic and Poland scored higher than the EU-15 average. Hungary, Latvia and Slovakia were also better than the United States (Figure 8).

Figure 8: The quality of education in New Europe relative to the OECD average



Source: Zsoldos and Zadornova (2008) based on OECD.

3. **New Europe is poised to receive hundreds of billions of euros in EU funding.** Until 2013, New Europe is likely to receive almost 200 billion euros; hundreds of billions of euros are likely to flow in decades to come. The majority of these funds, representing almost two percent of New Europe’s annual GDP, will be invested in high-return infrastructure, human capital, innovation and Information and Communication Technologies (ICT). Rosenberg and Serhiey (2007) estimate that inflows of EU funds are likely to accelerate GDP growth in New Europe by up to one percentage point a year. Allard et al. (2008) argue that EU funds financing public investment will increase New Europe’s per capita GDP relative to the EU-15 by a sizeable five percentage points by early 2020. Varga and Veld (2009) reach similar results. Most other emerging markets have no comparable source of financing.

4. **All countries in New Europe are set to adopt the euro within the next decade,** likely the world’s future premier reserve currency, accelerating growth per capita and increasing macroeconomic stability. According to Schadler et al. (2006) and the National Bank of Poland (2009), owing to higher trade and investment, lower risk premia and the elimination of currency exchange costs, adoption of the euro would increase GDP growth in Poland by between 0.3 and 0.7 percentage points annually. Other countries in New Europe would benefit to a similar extent by adopting the euro. Most other emerging markets have no comparable option.

5. **New Europe's productivity growth is mostly based on intangible investment.** Schadler et al. (2006) argue that unlike many other emerging markets, particularly in Asia, during the last decade productivity growth in New Europe has been mainly based on improvements in factor productivity (TFP), reflecting higher human capital, better business organization, and more qualified management, rather than the easier-to-achieve fixed capital investment, which also eventually runs into diminishing returns, slowing productivity growth.
6. **New Europe is inherently more stable than most emerging markets.** New Europe is likely to continue to grow faster than most emerging markets because of political, social and ethnic stability, which substantially limits the risk of disastrous political upheavals, social, ethnic and religious tensions and sustained periods of bad policymaking. Social stability in New Europe is stronger than in practically all other emerging markets, mostly due to much lower income inequality than elsewhere. The Gini coefficient, one of the main predictors of social stability, hovers around 30 in New Europe, while it exceeds 40 in Brazil, Russia, China, Thailand, Malaysia and in many other emerging markets (WIDER, 2008).¹⁴ Unlike most emerging market countries, New Europe is also ethnically and religiously homogenous. Political stability in New Europe is particularly strong relative to most emerging markets, and the countries are solid democracies, which are increasingly entrenched thanks to the ongoing institutional and political integration within the EU.¹⁵ The same cannot be said about most emerging markets, where democratic systems are either non-existent, like in China; not stable, like in Brazil; or not well entrenched like in Russia, Thailand or Malaysia.¹⁶
7. **EU membership limits the scope for growth-damaging populist economic policies.** There is very little that New European countries can do without breaching some of the many EU rules. It is practically impossible for EU member states to, for instance, undermine the independence of the central bank, discriminate against imports from other member states or provide undue advantage to local business interests. The rule of law is also firmly established, as any breaches would be invalidated by the European Court of Justice, whose decisions are legally binding in member countries. Strong domestic institutions, particularly independent central

¹⁴ According to the World Bank (2006) "inequality of opportunity, both within and among nations, sustains extreme deprivation, results in wasted human potential and often weakens prospects for overall prosperity and economic growth."

¹⁵ Barro (1996) finds that democracy has only a weak effect on growth. The positive effect decreases with rising income. However, Sen (2000) argues that democracy is crucial to ensure long-term economic stability, reduction of poverty and improved quality of life.

¹⁶ Thailand, for instance, long believed to have achieved a mature democracy, has been recently roiled by widespread public protests and even experienced a short military dictatorship.

banks, complement the institutional framework. The last decade showed that even mildly populist governments such as those of Poland's Kaczynski or Slovakia's Fico have become largely impotent.

The impact of the EU institutional and political straitjacket seems to be recognized by the financial markets--until the eruption of the global crisis, the cost of debt for New European countries was almost 100 bps points lower than suggested by standard macroeconomic fundamentals (Luengnaruemitchai and Schadler 2007). During the crisis this "EU halo effect" disappeared, but is likely to re-appear when the situation stabilizes.

Practically all other emerging markets have no institutions similar to that of the EU to restrain them from bad policymaking, as their domestic institutions are often too weak and not sufficiently entrenched. Emerging markets are also inherently politically, socially and ethnically much less stable than New Europe, increasing the risk of political upheavals leading to populist economic policies, as evidenced in countries like Brazil, Russia and India. They are likely to reoccur, particularly during the post-crisis period of slower economic growth, which will expose deeply ingrained social, political and religious fissures.¹⁷

Growth projections for emerging markets ignore such political and social risks.¹⁸ Instead, projections are based on extrapolating the most recent past into the future. But the future is not likely to reflect the recent past because the Golden Decade of global growth will not be repeated any time soon. This will increase risks to political, social, economic and military stability, to which emerging markets are much more vulnerable than New Europe, even though from today's perspective such risks seem to be remote. Even military conflicts cannot be excluded.¹⁹

¹⁷ Friedman (2006) argues that economic stagnation undermines such values as opportunity, tolerance, generosity and democracy, leading to political and social instability. It could be surmised that economic stagnation will be particularly dangerous for countries with weaker institutions and more pronounced social, ethnic and religious problems.

¹⁸ PWC explicitly ignores "the possibility of major adverse shocks (e.g. political revolutions, natural disasters or military conflicts) that could throw countries off their equilibrium growth paths for longer periods of time, but which are inherently impossible to predict" (PWC 2008, p. 23).

¹⁹ As argued by the Harvard historian Niall Ferguson (2009), military conflicts, even on a large scale, are quite likely in the future. Emmott (2009) argues that Asia will be particularly vulnerable to military conflicts, given the growing rivalry between Japan, China and India. Even Latin America is not immune to the risks of military conflicts, as reflected in the ongoing tensions between Venezuela and Colombia, arising from a long history of military authoritarianism, political populism and intermittent *coup d'états*.

The promising growth prospects notwithstanding,²⁰ New Europe has a number of weaknesses which could slow the speed of future convergence.

1. **Productivity growth in New Europe may slow.** This is mostly because, as argued by Van Ark and Piatkowski (2009), the easy post-transformation reserves have been almost completely exhausted. Productivity growth in the future, particularly as New Europe's level of productivity approaches the world's technological frontier, will have to increasingly rely not only on imported global know-how, but also on domestic innovation, a feat much harder to achieve, particularly given New Europe's low level of innovation. New Europe is virtually non-existent in the rankings of international patent applications (World Intellectual Property Organization, 2009).²¹ It also scores low in the Global Innovation Scoreboard 2008, the most comprehensive assessment of innovation performance of EU-27 and other major R&D spenders in the world (Figure 9).²² New Europe's rankings have worsened since 1995.²³

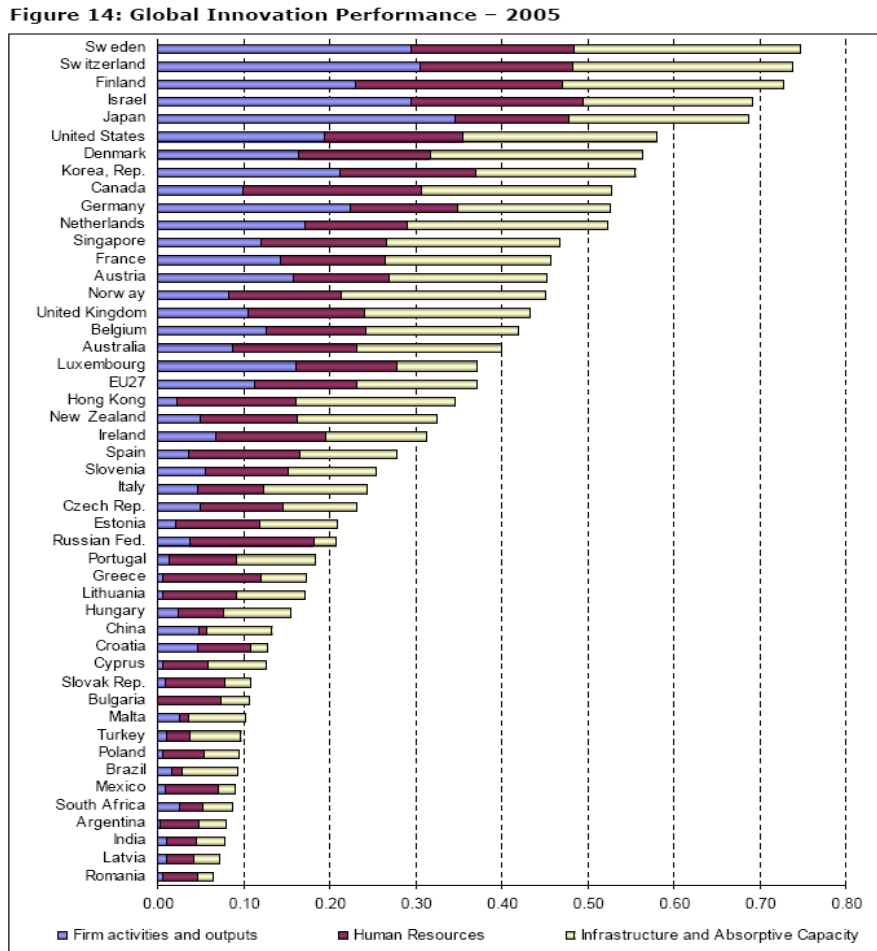
²⁰ To the long list of New Europe's strengths one could also add that New Europe's economies are well diversified, with no single country dependent on, for instance, exports of raw materials. New Europe is therefore better insulated than others from exogenous shocks stemming from such variables as the price of oil. New Europe will also benefit from further EU enlargement, which will possibly encompass the Balkans, Belarus, Ukraine, Moldova and Turkey.

²¹ Interestingly, in 2008, for the first time a Chinese company, Huawei, topped the list of patent applications with 1737 applications (a 20 percent increase over the previous year).

²² Argentina, Australia, Brazil, Canada, China, Hong Kong, India, Israel, Japan, New Zealand, Korea, Mexico, Russia, Singapore, South Africa and the United States. The GIS 2008 methodology includes nine indicators of innovation and technological capabilities, grouped in three main dimensions: Firm Activities and Outputs, Human Resources and Infrastructures and Absorptive Capacity. Nine indicators include patents per population (three-year average), business R&D (BERD) as a percentage of GDP, S&T tertiary enrollment ratio, labor force with tertiary education (percentage total labor force), R&D personnel per population, scientific articles per population, ICT expenditures per capita, Infrastructures and Broadband penetration per population, public R&D (HERD + GERD) as a percentage of GDP.

²³ See Radzikowski and Rybinski (2007) for a pessimistic view on New Europe's ability to generate innovations and develop intellectual capital.

Figure 9: Global Innovation Performance, 2005



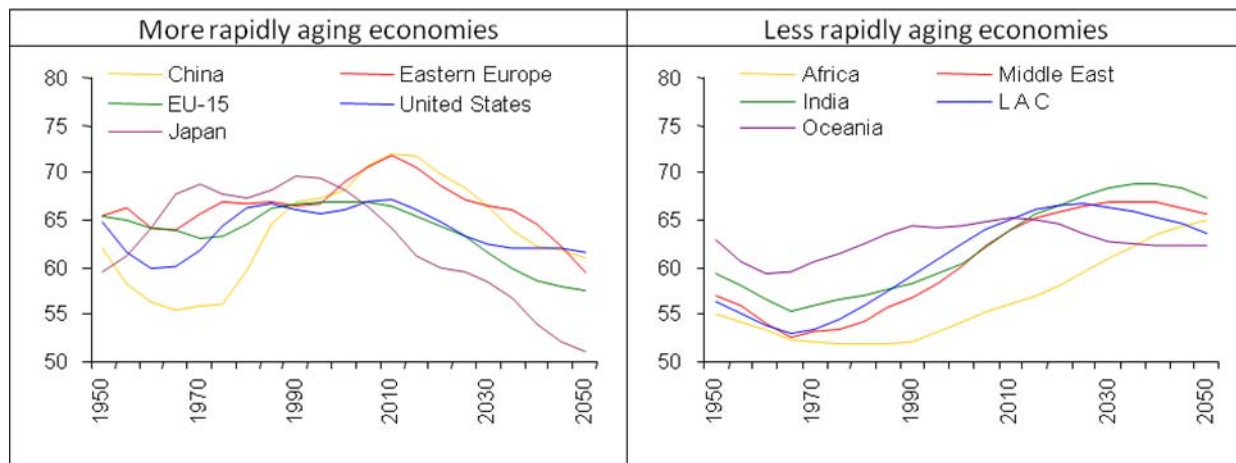
Source: Global Innovation Scoreboard 2008

2. **New Europe’s population is aging much faster than most emerging markets** as a result of lower birth rates and a negative demographic cycle (Figure 10).²⁴ Rapid population aging is likely to negatively impact productivity growth and public finances (The Economist, 2009). However, Carone et al. (2006) argue that while labor productivity of individuals aged 55 and older is likely to decline, the effect on productivity would be limited. The negative impact of aging on public finances is mitigated by the effect of pension reforms introduced in most New European countries, which shifted the burden from defined benefit, pay as you go (PAYG)

²⁴ The World Bank (2008) calculates there will be 18 percent fewer Bulgarians in 2025 than there were in 2000. The number of Hungarians is forecast to fall by 13 percent over the same period, while the Czech Republic, Poland and Slovakia can expect population shrinkage of 3-5 percent. In many of the new member states, one in five people will be over 65 by 2025 and the median age will approach 50.

systems, to a defined contribution, private-pension funds-based system.²⁵ However, the negative impact of aging is exacerbated by low labor employment ratios in New Europe, which are below the EU-15 average of 67 percent in 2007 (Poland and Hungary had an employment ratio of only 57 percent).

Figure 10: Population aging until 2050 according to the United Nations



Source: Rybinski et al. (2008) based on the UN.

- 3. New Europe's competitiveness is not improving as rapidly as elsewhere.** In the World Economic Forum's (WEF) Global Competitiveness Index 2008-2009, the best New European economies – Estonia and the Czech Republic – are ranked only in 32nd and 33rd place. Poland, the region's largest economy, is ranked 53rd. Rankings for almost all countries in the region have worsened relative to the previous year.²⁶

²⁵ The European Commission projects that owing to the implemented pension reforms, public spending on pensions in Poland in 2050 will decrease by 5.9 percent of GDP, while for EU-15 it will increase by 2.3 percent of GDP on average. However, projected spending on pensions in New European countries that have not yet implemented full pension reforms the Czech Republic, Slovenia and Hungary – will be even higher than in Western Europe.

²⁶ However, the predictive power of such rankings is quite disappointing. Despite the comprehensiveness of the Global Competitiveness Index – it aggregates more than 150 institutional, social, political and economic factors believed to influence competitiveness and long-term growth – Vartia and Nikinmaa (2006) provide statistical evidence that high rankings are not good predictors of future growth rates. They find that correlation between the 1996 competitiveness rankings and average annual GDP growth rates per capita during 1995-2003 is close to zero. Hawkins (2006) agrees, arguing that the WEF Index merely provides useful comparative information about economic conditions and business perceptions across economies. Other rankings' predictive power, such as the World Bank's Ease of Doing Business Index or the Heritage Foundation's Index of Economic Freedom, is likewise low.

- 4. It is not clear whether New Europe has any advantage in less tangible growth factors**, such as culture, ideas or beliefs, which are notoriously hard to measure. A number of studies suggest that stronger civic participation, emblematic of democracy, increases the public sector's efficiency and promotes faster growth as policymakers are held accountable for how they spend public money (see, for instance, Casiraghi et al. 2009). This would favor New Europe, where democracy is more deeply ingrained than in other emerging markets. However, other studies emphasize the importance of trust and of a dense network of associations for growth (Putnam 1993, Fukuyama 1996), seemingly favoring East Asia over New Europe, where the level of public trust and density of social networks is low (EBRD 2007). New Europe also seems to be disadvantaged by a relative paucity of strategic thinking, which to a large extent is due to the inherent features of a democracy, which usually favors short-term results over long-term ones. Such weakness, however, can be mitigated by the implementation of strategies developed for the whole European Union, such as the Lisbon Agenda.

Conclusions and Recommendations

New Europe has never had it so good. Income, quality of life and level of happiness have never been closer to that of developed countries in Western Europe since at least 1500. Despite the crisis, New Europe will continue to grow faster than Western Europe for decades to come. By 2050, New Europe's level of per capita income is likely to match that of Western Europe, the highest relative income level ever recorded in the history of the region. Moreover, the overall quality of life is likely to be indistinguishable from that in Western Europe. This is likely to herald the beginning of a new Golden Age for New Europe.

By 2050, New Europe, already a significant global player with a combined GDP about the same size as that of Brazil and Russia, is also likely to achieve a higher level of per capita income than most emerging market countries. While emerging market economies may grow faster for some time, they are nonetheless much more vulnerable than New Europe to political, social and economic Black Swans, catastrophic events which could wipe out much of the economic progress.

Such catastrophic events are likely as the world will increasingly face three trends, which in the past have almost always led to wars and economic retardation: (i) the rise of new powers upsetting the world's balance of power; (ii) ongoing depletion of world's resources, particularly water and oil; and (iii) growing emancipation of the world's poor, who will increasingly demand a louder voice in global affairs and a bigger share of the world's economic pie. As argued by Kolodko (2010) in his theory of coincidental growth, most dramatic events in economic history occur during a rare combination of circumstances which produce a perfect economic storm. New Europe, safely ensconced

in the legal framework of the European Union, insulated from global financial speculation by the euro and defended by its NATO allies, will be much less exposed to these rising dangers than most emerging markets. New Europe may grow slower in the next 40 years, but nonetheless achieve more.

The Golden Age, however, will not arrive without help from policymakers. The crisis showed that the current New European growth model based on domestic consumption fueled by imported savings, large FDI inflows, especially into non-export oriented markets such as financial services or real estate, and high imports supported by appreciating real exchange rates, has been undermined. In the post-crisis world inflows of foreign financing are likely to substantially diminish. The new model should combine the best characteristics of the New European model, i.e., openness to trade, high quality of human capital and advanced institutional framework, with those of the East Asian model, particularly higher savings rates, controlled exchange rate appreciation and diversified exports. The crisis provides a good opportunity to implement needed change.

To ensure fast long-term growth, apart from the standard recommendations of maintaining macroeconomic stability, improving public administration and enhancing public infrastructure, New European policymakers should consider the following policy prescriptions:

1. **Increase domestic savings** to raise investments, lessen reliance on imported savings and bring current accounts under control. Tighten fiscal policy to increase public savings and allow taxes to go up as well as down to strengthen public finances. Tax incentives for investment in non-productive assets such as real estate should be removed. To increase tax revenues, New Europe should consider coordinating personal and corporate taxation through, for instance, introduction of a minimum regional tax rate.²⁷ The EU's Stability and Growth Pact, which has not worked well, should be complemented with strong domestic fiscal frameworks to ensure that countries conduct anti-cyclical policies, i.e., they build fiscal surpluses during good times to be spent during bad times. Introduction of independent fiscal watchdogs, modeled on the American Congressional Budget Office or the Swedish Fiscal Policy Council, would be helpful. Incentives for private savings should also be strengthened, including through pension reforms.
2. **Re-emphasize labor productivity growth** to offset negative effects from lower inflows of foreign financing. As argued by van Ark and Piatkowski (2009), since the easy post-transition productivity growth reserves have been largely exhausted, to

²⁷ Piatkowski (2009) argues that introduction of a minimum corporate tax rate of 15 percent in the Central and Eastern European region, still much lower than in Western Europe, would likely limit tax competition and thus safeguard tax revenues without negatively affecting FDI. See also Piatkowski and Jarmuzek (2008) for a similar discussion.

ensure fast productivity growth in the future, New Europe will need to further enhance the quality of education, increase innovation and improve infrastructure. With labor productivity already exceeding half of the Western European level, New Europe needs not only to enhance absorption of imported technology, but also increasingly rely on domestic innovation. Inflows of Foreign Direct Investment (FDI), an important contributor to enhancing productivity, should continue to be attracted, but be directed more towards export-oriented rather than non-tradable sectors such as retail and wholesale trade, real estate and financial services. On the EU level, New Europe should continue to support full opening of the EU's labor and service markets to increase EU-wide competition and enhance incentives for innovation.

3. **Strengthen financial sector supervision and lessen reliance on foreign banks.** The crisis has shown that the fragmentation of the EU's financial sector's supervision first contributed to and then worsened the crisis. It is in New Europe's interest to support creation of a single pan-European financial sector supervisory body to equilibrate interests of the owners of capital from Western Europe with its recipients in Central and Eastern Europe. As argued by Akerlof and Shiller (2009), strengthened financial supervision would also help mitigate excesses and irrationality of financial markets. New Europe should also strive to lessen its reliance on foreign banks. One of the lessons of the crisis is that – as opposed to what often has been said by apologists of globalization--capital does have nationality, with foreign banks favoring lending in mother countries during the crisis rather than in New European subsidiaries. To increase control over credit growth, improve the banking sector's stability and conduct anti-cyclical lending policy, foreign banks operating in New Europe should be complemented with local private and public banks, similar to PKO BP in Poland or OTP in Hungary.
4. **Diversify exports** away from European Union markets, which now represent more than 80 percent of New European exports, towards fast-growing markets in Asia, Latin America and Africa. This would help insulate New Europe from local exogenous shocks and increase resilience towards changing European business cycles. Diversification could be achieved through an expanded use of export credit guarantees, partnership agreements with other world regions to promote access to local markets and support for FDI inflows from other emerging market countries.
5. **Adopt the euro as quickly as possible, at a competitive exchange rate.** Adopting the euro is a unique opportunity available only to New Europe, which would accelerate growth and reduce vulnerabilities. The crisis has shown that the benefits of a sovereign monetary policy are largely illusory, as the presumed monetary independence is undermined by the need to defend currencies against speculative attacks and attract sufficient foreign financing for the public and private sector. Floating exchange rates have proved beneficial, helping to absorb external shocks,

but have also been a source of macroeconomic instability by weakening public, corporate and household balance sheets. Choosing a competitive exchange rate is particularly important to ensure that it doesn't slow growth and undermine competitiveness, such as was the case in Portugal before and Slovakia now. As argued by Rodrik (2008), weak currencies have been one of the driving engines of growth in East Asia for decades, offsetting weaknesses inhibiting growth. Like in East Asia, New Europe should ensure that the pace of real exchange rate appreciation of their currencies, before and after the euro adoption, doesn't outstrip the pace of improvement in price competitiveness. Western Europe should help New Europe adopt the euro as quickly as possible by being more flexible on the euro entry criteria, which in the current form do not encourage growth (Piatkowski, 2008). Together, the whole EU should strive to strengthen the euro so that one day it replaces the U.S. dollar as the premier global reserve currency (Piatkowski and Rybinski, 2009).

6. **Increase labor participation and open borders to immigration** to slow population aging, increase the development of skills and improve productivity. New Europe should increase the effective retirement age for both men and women to closer to 70 years by eliminating early retirement schemes, increasing statutory retirement ages and enhancing incentives for lifelong employment. Retirement age should be linked to rising life expectancy. Tax and legal barriers to employment should be lowered. Telework and outsourcing should be actively promoted, including through tax subsidies, particularly for the elderly. On immigration, New Europe should fully open borders to immigration, particularly in the neighboring countries of Eastern Europe, with immigrants offered a road to citizenship, subject to language and legal employment tests. Immigration would bring similar economic benefits to those enjoyed in Western European countries attracting New European labor (Kahanec and Zimmermann, 2009). In the rising global strategic competition for human resources, New Europe should not remain passive. Large immigration is inevitable and it is better to manage it now to ensure the greatest benefits.
7. **Promote further integration and enlargement of the EU.** New Europe has a unique opportunity to be a part of the historically unprecedented and amazingly successful integration of the European continent, which most other regions of the world will try to emulate. New Europe has much to gain in an economic, social and political sense by more deeply integrating itself with Western Europe, the second largest economy in the world. New Europe can bring itself to bear on global affairs only through the European Union, and it would also be in its interest if the Union was enlarged to include the remaining countries in the Balkans, Eastern Europe and Turkey. Further EU enlargement would expand the zone of economic prosperity and political stability, providing new economic opportunities and mitigating political risks. The crisis should provide a new sense of common purpose for all Europeans and a unifying theme that we are all in this together.

8. **Support enhanced global cooperation and multilateralism.** The crisis has shown that New Europe, still on the periphery, is exposed to shocks imported from abroad more than developed countries in the center of the global economy. To mitigate the negative effects of the peripheral status, such as a high risk of sudden capital stops, New Europe should support strengthening of global financial institutions, starting with the IMF and the World Bank. The former has had a particularly positive contribution to lessening the impact of the current crisis in New Europe by providing financial support in the region when private markets shut down. New Europe, however, should also support regional financial initiatives, complementing the Bretton Woods institutions, such as the Asian Chiang Mai Initiative or the European Commission's Balance of Payments Facility. The more sources of crisis financing, the better. It is also in the interest of New Europe to support new multilateral forums such as G-20, where peripheral countries can finally have their say in global affairs. Given that its combined GDP rivals that of Russia and Brazil, the region should strive to have its own representative in G-20. Poland, the star performer during the last 20 years of transition and the current crisis, with an economy substantially larger than that of Argentina, Saudi Arabia or South Africa, would fit the bill well.

References

- Akerlof, G. and R. Shiller (2009) *Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism.* Princeton University Press.
- Allard, C., N. Choueiri, S. Schadler, and R. Van Elkan (2008) 'Macroeconomic Effects of EU Transfers in New Member States.' *IMF Working Paper 08/223*, September. From: <http://www.imf.org/external/pubs/ft/wp/2008/wp08223.pdf>
- Barro, Robert J. (1996), Determinants of Economic Growth: A Cross-Country Empirical Study NBER Working Paper No. W5698. Available at SSRN: <http://ssrn.com/abstract=3422>
- Bergheim. S. (2005) "Global Growth Centers 2020," Deutsche Bank Research, March 23.
- Casiraghi, M., Giordano, R. and P. Tommasino (2009) "Behind public sector efficiency: the role of culture and institutions" in: *The quality of public finances and economic growth* edited by S. Barrios, L. Pench and A. Schaechter, European Commission, Occasional Paper No. 45. March.
- Carone, G., Denis, C., Mc Morrow, K., Mourre, G. and Roeger, W. (2006), Long-Term Labour Productivity and GDP Projections for the EU25 Member States: A Production Function Framework. Available at SSRN: <http://ssrn.com/abstract=930421>
- Čihák, M. and W. Fonteyne (2009) 'Five Years After: European Union Membership and Macro-Financial Stability in the New Member States.' *IMF Working Paper 09/x*. April.
- EBRD (2007) *Life in Transition: A Survey of People's Experiences and Attitudes*. European Bank for Reconstruction and Development.
- Economist (2008) "Emerging Economies" *Economics Focus*, Jan 31st.
- Economist, The (2009) "A Special Report on Aging Populations." 25 June.
- Emmott, B. (2009) *Rivals: How the Power Struggle Between China, India, and Japan Will Shape Our Next Decade*, Mariner Books.
- European Innovation Scorecard (2008). From: http://www.proinno-europe.eu/EIS2008/website/docs/EIS_2008_Final_report.pdf
- European Commission (2009) 'Five Years of an Enlarged EU. Economic Achievements and Challenges,' February.
- Eurofund (2009) 'Second European Quality of Life Survey – First Findings,' European Foundation for Improvement of Living and Working Conditions.
- Fabrizio, S., Leigh, D. and A. Mody (2009) "The Second Transition: Eastern Europe in Perspective." European Commission, Economic Papers 366. March.
- Friedman, B. (2006) *The Moral Consequences of Economic Growth*. Vintage.

- Fukuyama, F. (1996) *Trust: The Social Virtues and the Creation of Prosperity*. Free Press.
- Goldman Sachs (2007) *BRICs and Beyond*. Goldman Sachs International.
- Hawkins, J. (2006), "The Concept of Competitiveness," Treasury Working Paper, April, Australian Treasury.
- IMF (2008) World Economic Outlook Database, October. From: www.imf.org
- IMF (2009) *Europe: Regional Economic Outlook*. International Monetary Fund, May.
- Kahanec, M. and K. Zimmermann (2009) "Migration in an enlarged EU: A challenging solution?" European Commission, Economic Papers 363, March.
- Keereman, F., S. Steinlein and I. P. Székely (2009) "Five Years of an Enlarged EU. Macro-financial stability," Presentation at the conference on "EU Enlargement – 5 Years After," Prague, 2 March, 2009. From: <http://www.eu2009.cz/event/1/302/>
- Kolodko, G.W. (2010) *World on the Move*, Columbia University Press, forthcoming.
- Kolodko, G.W. (2000) *From Shock to Therapy: The Political Economy of Postsocialist Transformation*, Oxford University Press, 457 pp.
- Layard, R. (2003) "Happiness: Has Social Science a Clue?" Lionel Robbins Memorial Lectures 2002/3. From: <http://cep.lse.ac.uk/events/lectures/layard/RL030303.pdf>
- Lucas, R. (1988) 'On the mechanics of economic development.' *Journal of Monetary Economics*, vol 22, no. 1, pp 3-42.
- Luengnaruemitchai, P. and Schadler, S. (2007), Do Economists' and Financial Markets' Perspectives on the New Members of the EU differ?, *IMF Working Paper*, No. 07/65, International Monetary Fund, Washington DC.
- Maddison, A. (2003), *The World Economy: Historical Statistics*, Development Centre Studies, OECD, Paris. From: http://www.ggdc.net/maddison/other_books/appendix_B.pdf
- North, D. (1990) *Institutions, Institutional Change, and Economic Performance*. New York: Cambridge University Press.
- National Bank of Poland (2009) "Raport na temat pełnego uczestnictwa Rzeczypospolitej Polskiej w trzecim etapie Unii Gospodarczej i Walutowej."
- OECD (2006), "OECD PISA PISA 2006: Science Competencies for Tomorrow's World.. From: <http://www.oecd.org/dataoecd/15/13/39725224.pdf>
- Piatkowski, M. (2009) "Konkurencja podatkowa i jej implikacje dla Europy Środkowo-Wschodniej," *Ekonomista*, forthcoming.
- Piatkowski, M. (2008) 'Time to loosen criteria for euro adoption,' *Financial Times*, December 17.

- Piatkowski, M. and K. Rybinski (2009) 'Let's roll out the euro to the whole Union,' *Financial Times*, June 11.
- Piatkowski, M., and M. Jarmuzek (2008) 'Zero corporate income tax in Moldova: Tax Competition and its Implications for Eastern Europe.' *IMF Working Paper 8/203*, International Monetary Fund, August.
- Poncet, S. (2006), "The Long Term Growth Prospects of the World Economy: Horizon 2050." *CEPII Working Paper 2006-16*.
- Putnam, R. (1993), *Making democracy work*, Princeton University Press, Princeton.
- PWC (2008) "Beyond the BRICs: Updated Global Growth Projections to 2050." From: http://www.pwc.co.uk/pdf/Beyond_the_BRICs.pdf
- Radzikowski, M. and K. Rybiński (2007) "Achieving Sustainable Growth: Will New Europe Fly or Crawl in the 21st Century Global Knowledge Economy," in Nadolny A. T. Schauer (eds.) *The Future of Europe. Sustainable Development and Economic Growth?* Vienna.
- Rapacki, R. and M. Prochniak (2009) "The EU Enlargement and Economic Growth in the CEE New Member States," European Commission, Economic Papers 367, March.
- Rodrik, D. (2008), "The Real Exchange Rate and Economic Growth", John F. Kennedy School of Government, Harvard University, Cambridge, MA.
- Rosenberg, C. and R. Sierhej (2007) 'Interpreting EU Funds Data for Macroeconomic Analysis in the New Member States,' IMF Working Paper 07/77, April.
- Rybinski, K., P. Opala and M. Hołda (2008), *The Gordian Knots of the 21st century*, Ministerstwo Rozwoju Regionalnego, Warsaw.
- Schadler, S., Mody, A., Abiad, A., and D. Leigh (2006) 'Growth in the Central and Eastern European Countries of the European Union', IMF Occasional Paper 252. Sen, A. (2000) *Development as Freedom*, Anchor. 406pp.
- Van Ark, Bart and Marcin Piatkowski (2009) 'Productivity, Innovation and ICT in Old and New Europe,' in: D. W. Jorgenson (ed.) *The Economics of Productivity*, London: Edward Elgar, p.224-279.
- Varga, J. and Veld, J. in't (2009) "A model-based assessment of the macroeconomic impact of EU structural funds on the new Member States, European Commission, Economic Papers 371, March.
- Vartia, P. and T. Nikinmaa (2006) "What Do Competitiveness Comparisons Tell Us." http://etla.fi/files/1255_FES_04_4_what_do_competitiveness_comparisons_tell_us.pdf
- White, A. (2007) 'A Global Projection of Subjective Well-being: A Challenge. To Positive Psychology?' *Psychtalk* 56, 17-20. From: <http://www.le.ac.uk/users/aw57/world/sample.html>

WIDER (2008) 'World Income Inequality Database V2.0c May 2008.' World Institute for Development Economics Research. From:
http://www.wider.unu.edu/research/Database/en_GB/database/

Wilson, D. and R. Purushothaman (2003) 'Dreaming with BRICs. The Path to 2050.' Goldman Sachs Global Economics Paper 99.

World Bank (2006) *World Development Report 2006: Equity and Development*. World Bank.

World Intellectual Property Organization (2009). From:
http://www.wipo.int/pressroom/en/articles/2009/article_0002.html

Zsoldos, I. and A. Zadornova (2008) 'New EU Member States - a Fifth BRIC?'" Goldman Sachs Global Economics Paper No. 173, September 28.