

“ECONOMIC IMPACTS OF EU INTEGRATION – REGIONAL AND NATIONAL VIEW”

**South East Europe: The EU's Next Enlargement
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Višnja Samardžija, Ph.D
Institute for International Relations, Zagreb, Croatia

1. Experiences of the Fifth enlargement – opportunities and risks for the EU and new EU countries

It is said that when Henry Kissinger asked Zhou Enlai, Mao's right-hand man, to comment on the significance of the French revolution, he replied “too early to say”.

- ☛ Eastern enlargement is one of the biggest events in Europe in our time. However, it will take decades before a full insight into overall consequences will be possible. One year after accession is too short time for an assessment, but some general impacts are already visible.
- ☛ It is particularly difficult to estimate what might be the impacts of enlargement for the SEE (or Western Balkan) countries - the Accession Treaty with Bulgaria and Romania has already been signed, meaning that before the potential accession of SAP countries into the EU, another enlargement will happen in 2007. The key issue for SEE countries is to learn from the experiences of the new MS and adjust it to their own situation.
- ☛ General conclusion is that the enlargement did not produce major negative effects for the new MS, since the countries passed through intensive preparations during the accession. On the opposite, the EU-10 are already benefiting from the first positive impacts of accession. Positive experiences – better chances for the next enlargement.
- ☛ However, it is clear that even in most positive scenarios, catching-up in EU-10 could take years according to macroeconomic figures, in spite of the fact that the reform process has been quite speedy and the new MS are taking the Lisbon process very seriously.

2. General impacts of Fifth enlargement influencing continuation of the process

Preserving the institutional memory: Much could be learned from the CEECs experiences of transition and integration. Furthermore, the EU itself is better prepared than it was in the early 1990s.

However, an easy replication of the CEE '*success story*' could not be guaranteed.

(i) Increasing the wealth gap

– uncertainty for new enlargements?

– similarity with next enlargement

- ☛ Enlargement increased the wealth gap within the EU and changed its picture. Therefore it will take time the EU to “digest” 10 (+ 2) new members. This might mean uncertainty of new enlargements that are expected to follow soon.
- ☛ The fifth enlargement is a new experience for the EU in terms of integrating transitional Eastern European countries, former centrally planned economies, and the enlargement with deepest economic disbalances among acceding countries (integration of European wealthy economies with a group of mostly transitional economies).
- ☛ The fifth enlargement was very different from previous in terms of economic differences. The average GDP p/c (PPP) 10 new MS was approximately 40% of the EU 15 (ranging from 41% in Latvia to 77% in Slovenia). The richer new member states (Slovenia, Czech Republic, Hungary) are in terms of purchasing power closer to the EU average than Spain and Portugal were when they joined, while the other countries are under the level that Portugal had in 1986.
- ☛ With this enlargement that the EU turned from the average GDP per capita of 24.100 Euro among 15 member states, to average of 21.100 Euro GDP p/c, produced by 25 member states.
- ☛ Bulgaria and Romania - further enlargement will deepen the wealth gap even more. Bulgaria and Romania are the first two countries that signed the Accession Treaties (25 April 2005), accession expected in January 2007.
- ☛ SAP countries – stronger GDP growth needed to catch-up (average 4% in 2003), macroeconomic indicators improving, inflation in decline, positive trends in fiscal consolidation since 2000. Although they made some steps forward in market reforms and adjustment to EU standards, further progress urgently needed!

- ☛ Another difference from previous enlargements was the fact that most of the new MS were completing the transition from centrally planned economies to a market-based system. This is the case with next enlargement (Bulgaria, Romania), while in potential integration with the SAP countries faces some additional issues that have to be dealt with before accession (nation state building, fulfilment of the *SAP criteria*, such as cooperation with ICTY, refugees return, strengthening the regional cooperation).

The need to overcome the EU enlargement fatigue (SAA reform fatigue)

(ii) New dynamism – challenge for the SAP countries

- ☛ The new member states are dynamic and fast growing economies. This dynamism will benefit the whole EU and therefore the *new dynamism* is a positive factor for potential future enlargements.
- ☛ The last Economic Forecasts (Spring 2005) show that in 2004 the growth rate was higher in the EU as a whole (2.4%) than the average growth in the Euro area (2%). The projections also indicate higher growth potentials for the EU in 2005 (2% compared to 1.6% in Euro area) and 2006 (2.3% in EU and 2.1% in Euro area).
- ☛ The growth in EU-10 is expected to be continued in 2005 and 2006 by 5%, which seems to be not enough for the catch-up process. Continued, but even accelerated growth performance will be needed in EU-10 for a successful catch-up. Namely, experience shows that Ireland and dynamic Asian economies grew 9-10% during their most intense catch-up phase. The need for keeping the high growth rates was also underlined in the Kok Report. Romania is experiencing fast growth by impressive 7.5% in 2004.
- ☛ SAP countries have relatively good economic performance since 2000 with the average growth over 4%, resulting from accelerated investments through privatisation and FDI. However, this will not be enough for the catch-up process. Inflation is in decline.

2. Challenges (and impacts) of integrating the SAP countries into the EU

'The future of the Balkans is within the European Union' (Thessaloniki Summit). All countries of the region now share that vision. Some pre-accession instruments were opened for the region, different stage of integration.

Integration challenges – of integration started, countries at different stage of integration with the EU. What kind of effects could be expected, what was achieved?

Expected impacts

- Ø Speeding up reforms and transition process, more efficient implementing reforms (transition + integration). Challenge for SAP: necessary to shift from stabilisation and reconstruction to EU integration and sustainable development;
- Ø Structural reforms – key issue for SEE (substantial progress in privatisation, but social services, pension reform, health reform, etc.
- Ø Strengthening competitiveness (Croatia in Global Competitive Index)
- Ø Legal harmonisation +
- Ø Development of policy capacity (implementation of rules that make the acquis; progress from formal adoption of legislation to development capacities to implement)
- Ø Creation of new institutions, administrative capacity building
- Ø Effects of trade liberalisation
- Ø Inflow of FDI
- Ø Strengthening complementarities (Hungary competing with Ireland to attract computer assembly; Slovakia on the way of becoming Europe's major manufacturer; Estonia subcontractor of Swedish cloth firms and Ericson)

Impacts on trade

- ⌘ CEECs: Trade integration of candidates with the EU already started before the enlargement. Trade was largely liberalized during 90s. Therefore membership meant moving into customs union from a pre-existing free trade area. Therefore there was only a small immediate impact on trade in goods, but further gains will be manifested in the medium and long run, as a result of increased investment and further specialization of production.
- ⌘ SAP countries – Trade deficits with EU.
- ⌘ Poor foreign trade performance which reflects general weakness of their economies. SAP countries did not succeed to take full advantage of the asymmetric trade liberalisation with the EU. Reasons – lack of productive

capacity, insufficient ability to comply with EU quality standards, non participation in Pan-European Diagonal Cumulation of Rules of Origin.

- ☛ But, SAP have significantly increased their external trade (60% over the period 1999 to 2003). The growth rate was higher with the EU than with other partners. The EU-25 is the number one trading partner, accounting for more than 84% of the region's trade. Croatia is the major partner of the EU, amounting for 50% of the region's trade.
- ☛ Network of FTA in the region completed, but half of thede FTAs still have to be implemented. However, intra-regional trade rather limited (Croatia-B&H and S&M-Macedonia account nearly 75% of the total trade within the region). Problem: very similar specialisation pattern (mostly labour intensive and and basic products).
- ☛ Important to establish integrated economic space (FTA + infrastructure). Regional Electricity Market (REM) established, the agreement on Energy Community between EU and SEE recently initialled, to be signed within 3 months.
- ☛ Implications of cooperation with enlarged EU
- ☛ Enlargement to 25 means benefits to EU trading partners: the SEE countries will cooperate with the EU of 25 members, amounting more than 450 million citizens, accounting for roughly 18% of world trade and contributing to more than 25% of the world's GDP.
- ☛ One of the first direct consequences of the fifth enlargement for some SAP countries was the need of adapting provisions of already existing Stabilisation and Association Agreements (signed with EU-15) to the EU-25. This was the case with Croatia and Macedonia, as the only two countries having signed the SAAs.
- ☛ In practical terms, it was necessary to extend to other EU members trade concessions given previously to 6 candidate countries through the previously signed free trade agreements, and to adjust the SAA to the situation of the enlarged EU-25. This was done through signing the Protocol on Enlargement (Protocol 7), relating to agricultural products. The implications were twofold: it gave Croatia access to wider European market, including to the countries with which preferential agreements were not signed before. But on the other hand, the concessions given to the former 6 candidates were partly extended to the enlarged EU.
- ☛ Transformation of subregional integrations - future of CEFTA?

- ☛ The consequence of enlargement is the weakened CEFTA, with only three members (B, C, R and Macedonia as applicant). It opens question on the future model of the FTA in SEE – lowering standards of CEFTA, or unifying the existing FTAs between the countries.
- ☛ One of solutions is creating SEFTA, but with lower standards (A, C and M are members of WTO; only two countries having SAA).

FDI inflow

- ☛ EU-10: Increased investment is one of most significant advantages of the EU accession. The FDI to candidates was mainly channelled into industry and infrastructure, such as energy and telecommunications.
- ☛ No further stronger rise in FDI inflow is expected after the accession, given the already high level of FDI before accession, the ending of special fiscal incentives and the completion of privatization process, although it is not excluded, depending on the extent of sound adjustment policies and good governance at national level. Some additional flows were expected to come resulting from new investment projects that were under preparation before enlargement.
- ☛ SAP - FDI will have crucial role in future development of the region, as an impetus for the economic recovery, speeding up economic growth and reducing poverty. Increased foreign interest for the SEE region, FDI growing.
- ☛ In the period between 1989 and 2003, cumulative net FDI to the region was about 32 billion US\$, which is far below the level of FDI (125 billion US\$) directed to CEE and Baltics in the same period.
FDI inflows have been relatively stable between 1998-2002 (around 3.5-4 billion US\$), while 2003 showed significant increase to more than 6 billion US\$.
- ☛ SEE countries had much lower FDI p/c (80 Euro) than acceding countries (230 Euro).
- ☛ Croatia – largest share in FDI, 50% of total FDI inflow (privatisation process, banking sector, telecommunications). Annual average share of FDI to GDP 5.6% (1997-03).

- ☛ The main type of capital inflow mostly linked with privatisation process, mainly large scale privatisation, but there are also examples of increasing greenfield investment in the region.
- ☛ Recently the inflow of FDI from several new EU members (Hungary). One of the examples is the acquisition by a consortium led by Hungarian company MATAV of a majority share in MAKTEL, the fixed-line telecommunications company in Macedonia, so Hungary was the largest investor in Macedonia in 2002.
- ☛ Intra-regional FDI is also starting to expand among SEE. Within the region, Croatia is a top investor in Bosnia & Herzegovina, and Croatian firms are now expanding to Serbia & Montenegro market (the recent purchase of Frikom, the largest ice-cream and frozen food manufacturer in Serbia and Montenegro, by Agrokor, Croatia).

Technical assistance:

Simplification in management of pre-accession programmes?

- ☛ EU-10: benefited from PHARE and other pre-accession programmes. Process of learning for the EU and candidates.
- ☛ The SAP countries in the region have been receiving technical assistance from CARDS, from budget line 4 (External Actions).
- ☛ Croatia with getting the candidate status was moved from the EU budget line 4 (External Actions) to budget line 7 (Enlargement). Aid in line 7 was intended for former candidate countries (10 countries of Central and Eastern Europe, along with Cyprus, Malta) and Turkey.
Croatia has access to pre-accession funds – Phare, ISPA and SAPARD. In the period 2005-06, 240 million Euro will be allocated for Croatia from these funds.
- ☛ The remaining SAP countries, being *potential candidates* will continue benefiting the CARDS programme.
- ☛ It seems that the experiences of complicated management of pre-accession programmes led to certain simplifications. In the new architecture, proposed within the Financial Perspectives 2007-2013, the new Pre-accession instrument, IPA is envisaged for candidates (Turkey, Croatia) and potential candidates (remaining WB countries). The IPA will supersede the existing instruments (PHARE, ISPA, SAPARD, CARDS and Turkey pre-accession

Regulation), and will hopefully simplify the management of programmes for accession countries.

€ Need to build the
absorption capacity (CARDS- Croatia 31,7%)

CROATIA – is the fast track approach possible?

- Ø *Economically* high above the average of the region (GDP p/c 6,220 Euro in 2004; higher than in R&B), growth rate 3,8% in 2004; problems high budget deficit (4,8%)
- Ø *Forerunner of integration* – *Avis* (2003), candidate country, Pre-accession strategy (2004), access to Pre-accession funds, Negotiation framework defined
- Ø *Start of negotiations postponed* – “Task Force” established, full cooperation with ICTY the remaining precondition
- Ø *Future of relation with EU* – fulfilment of Copenhagen criteria, implementation, “*own merits*”, “catching-up.
- Ø Model for SAP countries (“*exemplary candidate*”)
- Ø “*Europessimism*” growing – need for speeding up the integration
- Ø The European future of Croatia is in its’ own hands.

Individual progress towards EU integration is not changing regional picture of SEE region

- Ø *avis* and candidate status does not mean exempting Croatia from the region (*erosion*), Croatia still part of SEE willing to contribute to regional development
- Ø *candidate status* - positive factor for changing the perception of the region, motivation for others
- Ø a *vehicle* to achieve stability - strengthening regional cooperation through integration into EU (not a competition, but cooperation between the SEE countries)

Public opinion

Support for enlargement

The support to further enlargement is stronger in EU 25 than it was in the EU 15 (37%) and that the citizens of new member states are the strongest supporters of next enlargement.

The results of the Eurobarometer 62 survey (December, 2004) show that more than a half of people interviewed (autumn 2004) were in favour of a proposed further enlargement in the coming years (53%). This was a significant increase, as compared to 37% of citizens in EU 15 that had positive response before enlargement (spring 2004). It is a sign that the citizens have an impression that a last enlargement was a success and that there were no major problems in integrating 10 new member states in May 2004.

In Croatia there was a strong public support during the past years for integration into the EU: public opinion surveys carried out since 2000 on a six month basis showed that around 70% of population have positive attitude towards integration. However, recent surveys (2004) indicated significant decrease in public opinion support. In mid 2004, some 55% citizens had generally positive opinion of the EU. Very few citizens have extreme negative attitude, but generally the support for the accession of Croatia is on the decline (51% of citizens answered “*in favour*” of accession).

This shows that strengthened communication strategy encompassing not only urban but rural population including particularly important target groups, information campaigns, strengthened education activities, particularly those focused on media will be needed in Croatia.

End:

The enlargement is much wider process than trade and investment only. New member states enrich EU not only economically, but also culturally and in human terms. It is a process of building new Europe, with new way of thinking and new ideas. The SEE countries could also give their contribution to it.

Costs and benefits

One of the previously done estimations (Grabbe) was that the EU (particularly “old MS”) would gain about 10 billion euros over a long run, increasing their GDP by one-time gain of 0.2% which could lead to creation of an estimated 300.000 jobs, on the assumption of a constant labour/output ratio. It was estimated that this economic gains would be distributed unequally across the old MSs, with Germany accounting around 1/3.

The gains for the new MSs were expected to be proportionally higher (Pelkmans). Different trade induced simulations came to the conclusion that the new MSs as a group could gain between 1.5% to 8 or even 10% of the GDP in short or medium term.

In a longer run, the dynamic effect may lead to further economic growth in new MS. But, this dynamism is not automatic and will depend on the adoption of the sound pro-growth policies by the new MS, and the EU as a whole.