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FOREWORD

On the occasion of the five-year anniversary....

Nicolae Idu*

We celebrate the five-year anniversary of the European Institute of Romania with the feeling of having accomplished several projects that contributed to Romania's preparation for its accession to the European Union.

What do five years mean? An important period at least in terms of accomplishments for a country in transition like Romania and for an institution that was involved directly into the clarification of pre-accession issues. Most obviously, in other systems, five years do not mean much. For instance, I remember that the Director of the European Institute of London School of Economics told me in 2000 that, the organization he was heading, at its tenth anniversary, was considered to be „a young institution” (according to British standards).

The setting up of the European Institute of Romania was a necessity and, throughout the past five years, EIR has not only provided inputs to policy-making, trained public servants and translated the Community legislation into Romanian, but it has also initiated and stimulated the civil society debates with regard to Romania's road to the EU and the future of the EU.

EIR was a greenfield investment, because Romania, in comparison to its Central and Eastern European neighbours, had not started, not even in an embryonic phase, a tradition of debates regarding the European construction. That is why one of EIR's important tasks was to encourage the

European studies in the universities by establishing the Romanian European Community Studies Association and by setting up a pool of trainers in the field of European affairs and, most of all, in the field of project cycle management.

At the same time, EIR functioned as a disseminator and information multiplier through its publications among which it is worth mentioning here, besides the Romanian Journal of European Affairs in which I express these thoughts, the collection of Working Papers, the Pre-Accession Impact Studies and the glossaries of terms of the *acquis communautaire* series.

Actually, Jonathan Scheele, the Head of the European Commission Delegation in Bucharest and a close friend of the EIR, said the following: „The European Institute of Romania has become well-known throughout the years in the field of accession preparations. First of all, by translating the *acquis*, an extremely difficult task, given the fact that there are over 80 000 pages, and the fact that in many of the new Member States this task has not been carried out before the accession itself. Second of all, EIR has contributed to the training of public servants in Romania, helping them to undertake the huge responsibility of implementing the Community legislation in Romania. Third of all, through the coordination of the impact studies projects, EIR has drawn the attention of the public opinion, maybe too much, onto the concept of costs of the accession. It

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is extremely important for everybody to be aware not only of the benefits of European integration, but also of the derived constraints. Last, but not least, the EIR has organized debates with Romanian and foreign personalities involved in the European construction. All these actions define the EIR as a reliable partner both of the Delegation and the Government in the framework of the accession impact communication strategy to the population."

What has to be mentioned is that the EIR has brought to the interested audience keynote speakers in the field of European integration in the framework of the public events that it organized. Among its guests, there were representatives of the political arena, independent expertise, think-tanks and European universities. A lot of them are authors of famous works in the field.

The EIR has represented a pool and a resource that first line institutions in the accession preparations have used, not only by making the best of the EIR products, but also by taking over a number of readily prepared experts.

This year, between the 8th and 10th of June, the EIR organized an anniversary conference, celebrating five years of activity. Several personalities from Romania and abroad took part in this conference and have spoken in appreciative and encouraging terms about the Institute, also presenting standpoints regarding the future of the European construction.

In the pages of this issue, we host some of the valuable interventions at the EIR conference, among which: the Governor of the National Bank of Romania, Mugur Isărescu, the current and the former Minister of Foreign Affairs, Mihai-Răzvan Ungureanu and Mircea Geoană, respectively, the

former Minister of European Integration, Ene Dinga, but we also felt close to us the EIR's friends who could not be present at the conference, such as: Karen Fogg, the first ambassador of the European Commission in Bucharest, Jacques Pelkmans, the reknown professor of the College of Europe from Bruges, Enrico-Grillo Pasquarelli, the negotiator of the European Commission for Romania, Daniel Dăianu, the well-known professor and economic analyst.

This anniversary moment would not have been possible without the support of Alexandru Herlea, Mugur Isărescu, Karen Fogg, Eugen Dijmărescu, Catherine Day, Enrico Grillo-Pasquarelli, Ioan Ștefan, Christos Makridis, Jonathan Scheele, Iulia Deutsch, Costea Munteanu-Gurgu, Jacques Pelkmans, Aurel Ciobanu-Dordea, John Callagan, Raluca Diamandescu, Dana Simion, Anne de Ligne, Brendan Glynn. Therefore we are thankful and grateful to these friends of ours who understood at that moment the necessity and the importance of this project, named the European Institute of Romania.

I am really confident that, after a rather long transition and pre-accession period, Romania will join the EU by 1st of January 2007. But, what sort of member state will be Romania?

Even if it hasn't yet solved all its structural problems, Romania remains, on a medium and long-term perspective, a challenge for investments, due to the facilities of the taxation system and its natural resources.

Some of its exceptional assets are the rather cheap, but highly qualified labor force, the proficiency in foreign languages and adaptability to multicultural environments. Europe should start to see a

different Romania than that sketched by the clichés related to low qualified nationals traveling abroad more or less legally looking for jobs. Considering ageing population in the EU, Eastern Europeans working abroad could be seen as part of the solution for the sustainability of the European social security and pensions system.

Moreover, thousands of Romanian specialists in high-tech, IT or medicine, could stay home in Europe, after accession, instead of crossing the Ocean to join US companies, thus adding impetus to the pursuit of the Lisbon Agenda objectives.

While turning from sideline to gateway of the EU, Romania has the possibility of bringing valuable input in the designing and implementing of the EU neighbourhood policy at the Eastern borders, especially with regard to Ukraine, Moldova and the Middle East.

Last, but not least, Romania brings into Europe a unique natural landscape, being the last habitat of certain species extinct in other European countries. Romania's traditional heritage, based on authentic rural culture, will come to enrich the EU's "unity in diversity".

NEW AND FUTURE MEMBER STATES: ROMANIA'S ROLE IN THE EU-27*

Mugur Isărescu

I am glad to be here with you, at the European Institute of Romania, a forum which I am related to both due to my first profession, the academic one, and to the fact that, to a certain extent, I have contributed to the setting up of this Institute in the spring of 2000, when I was Prime-Minister.

I welcome the initiative of the Institute to organize a debate about the role of Romania in the EU-27. I consider this debate topical and timely.

Of course, there is room for other opinions. After the votes of the French and Dutch against the Project of European Constitution, to which can be added the initiative of the Italian labour minister, who wants a referendum on the single currency, it was natural to have voices questioning the very reality of enlargement. Related to this, is it possible to have to answer to an even more serious question: can we still hope, under the new circumstances, to have a united Europe with 27 countries?

The question is not meaningless. Undoubtedly, the European Union is going through difficult times. There could emerge even stagnation periods. They would not be the first ones, or the last ones. A thorough analysis shows us that the political, social and economic interests that converge towards continuing the enlargement, towards strengthening the European Union, actually, are more powerful and better argued reasons than the ones which, sprung

from certain fears related more to the past than to the future, want more stagnation or even steps backwards.

The logic of history urges me to believe that the enlargement process, pondered over thoroughly, will no longer be stopped. Therefore, talking today about Romania's role in a EU with 27 countries cannot be an action against history's mainstream. On the contrary, I consider this action natural and necessary.

In a multipolar world, characterized by an increasing competition among the big blocks of countries, Europe is condemned to a continuation of the deepening of integration, unless it wants to turn itself into a museum of civilization, good only for future entertainment of American, Japanese, Chinese and, why not, Indian tourists.

In this context, it is useful to remind ourselves constantly of the trade-off the Union was based on from the very beginning: less sovereignty in exchange for more power and more competition, conferred by the membership of an influential political-economic block. Due to the fact that it has become increasingly obvious the fact that none of the European states, individually, is capable any longer to project its force and promote its interests in a satisfactory way for the globalized world, increasingly competitive, which we entered. It is useful to remember right now this originary trade-off, especially in the

* Speech delivered by Mr. Mugur Isărescu, Governor of the National Bank of Romania at the 5th Anniversary Conference of the European Institute of Romania: "NEW AND FUTURE MEMBER STATES. HOW TO ACT IN EU-27?", held in Bucharest, 8th-10th June, 2005.

context defined by the French and Dutch negative vote.

On the other hand, it is obvious that the other aspect, the one of the Union's enlargement will take place under certain constraints and new complications, with obvious implications for the accession of our country, too. Besides the strict observation of the European treaties, which contribute to the long-term construction of the European project, Romania will have to assert its potential in front of the other partner countries, which constitutes an asset for the Union, not a liability, as many might think.

When I say asset, I refer, first of all, to a big market, the second largest in Central Europe.

Secondly, I think of the fact that our economy still has significant resources for increasing the productivity, made possible by the current combination of scarce capital and abundant labour force.

Thirdly, I consider an asset also the potential of inventivity and acceptance of change, that the Romanian people have proven throughout its history.

We have already concluded Romania's accession negotiations to the European Union. It was a difficult exam. We were convinced that we would succeed, with all the shortcomings and difficulties encountered. Actually, the officials of the European Union themselves expressed their confidence in the capacity of our country to finally comply with the conditions to join in 2007. The responsibility is on our shoulders now. If Romania keeps on complying with the key objectives it has set for itself, related to the nominal and real convergence, we will be able to say that we took a great step forward towards the European integration.

Under the circumstances in which Romania will gain greater credibility, will convince the European authorities of having adopted better measures, will prove reliability in fulfilling them as such and that, at the same time, will act concretely towards improving the business environment, our country will smoothen itself the way towards the European Union.

At the emotional level, undoubtedly, the recent debates within the European Union, especially the deepening of the fears related to enlargement, have complicated things with a less predictable element. The requirements will be greater, the conditions tougher and the reluctance more outspoken.

However, neither the toughening of the accession conditions nor the stronger pessimism in the enlarged Union, is news. We are already used to our European dream passing extremely difficult and tough exams. Immediately after Maastricht, we discovered that the rules of the European Union have been considerably tightened. The membership continued to entail a lot of privileges, but a lot of obligations were also included. Even countries with powerful economies, members of the European Union, face difficulties in integrating into the monetary and fiscal mechanism and see themselves threatened with not being able to fulfill the criteria regarding the public deficit. Therefore, we have to understand that the European Union does not lay in front of us a rose petal carpet. The road is bumpy, but we are left with no other option for sustainable development. Anyway, the accession process has become the very catalyst of Romania's modernizing process.

From the very end of 1999, Romania's invitation to start the accession negotiations has given a fresh impetus to the transformation and modernization of the

entire Romanian society, through the gradual, but unflinching takeover of Community's policies, policies that are accepted by consensus by all democratic forces in Romania.

Starting 1999 to this day, continuously, our development programs have been decisively focused on making the best out of the opportunity of European integration. This way, we have secured the purpose and the means, highly uncertain until that moment, in our reform efforts.

Obviously, it was not easy at all for our society and it is not easy now to defeat its reflexes, habits, conservatism. However, we can no longer delay the measures agreed on to change ourselves, to change the country, to change our way of living.

I was Prime Minister in early 2000, immediately after Romania's invitation to open the accession negotiations. I perceived, at that time, a continuous increase in the interest of the European Union for our country. The President of the European Commission, Romano Prodi and the Enlargement Commissioner, Günter Verheugen, came to Bucharest. We set then the first details to prepare the negotiations.

The first important exam the government I headed had to pass, was the elaboration of the medium term Development Strategy. As Prime Minister, I headed, with the academician Tudorel Postolache, the validation commission, which had the mission of making a unifying work. Actually, there was accomplished an excellent synthesis of several thousand pages of political parties', labour unions', employers', universities', research institutes' strategies. Then, we gathered around us 1500 experts of the Governments, of the parties, of the labour unions and

employers, of the Romanian Academy, most of them representing the civil society, in a wide debate which lasted for a few months, related to an open project: preparing the country for the European integration. This project finally received the blessing of the religions of Romania, which signed a declaration of support.

For many points of view or positions, it was impossible to find a common denominator. It was natural. Under these circumstances, the debates of the validation Commission have had an essential importance because they helped to express and clarify positions, shedding light onto the landscape of the entire Romanian society.

The strategy, as it was outlined, with the participation of social partners and political parties, have offered a long-term guarantee, without possibilities of comeback, of the placing of our country on the track of reforms and European integration, regardless of the electoral calendar. A guarantee that was strengthened, at that time, by the political declaration signed by the presidents of all the parties represented in the Parliament.

During those few months, at the beginning of 2000, when I worked for the elaboration of the Strategy, I understood how difficult it is, in our society to search and find consensus points, to negotiate with groups dominated by the most diverse interests. Especially in an electoral year, when short terms objectives prevail. And the Strategy involved medium and long-term objectives. Nevertheless, it was worth the effort. To those skeptics, the ones who saw the Development Strategy as nothing more than fulfilling a formality required by the European Union, with objectives that will never be accomplished, I will say today, after five years, having on my side the

harshes judge, which is time, that they were wrong. What I predicted then has come true: both inflation of less than 10% and the economic growth of over 5% and the fiscal and current account deficits fell within the limits required by the European Union.

The strategy we concluded, true orientation and guiding plan for many years, has constituted a common basis for a continuous line of the governance. Especially the objectives established then were enshrined in the agreements with the International Monetary Fund and the pre-accession programmes.

Actually, the strategy was drafted and launched during the Isărescu government, applied by the Năstase government and continued now by the Tăriceanu government. Its main idea, to which the major lines of developing the country in the upcoming years were circumscribed, was explicitly formulated: "Let's commit ourselves together!". Consequently, when the government I headed finished its tenure, the next government did not have to start from the scratch and elaborate a new strategy. Especially given the fact that the objectives we established back then together with all the political, social, economic, scientific forces were based on a financial and technical assistance compact programme, agreed upon with the European

Union, the World Bank and the International Monetary Fund.

Of course, both Năstase and Tăriceanu governments elaborated their own plans of action. But the Strategy of 2000 was and remained a Charter of Romania's accession into the EU.

I resorted to this example of the Medium-term Development Strategy for two reasons. First of all, because I consider it more and more obvious that what Romania needs now is a medium and long-term strategy in the field of taxes and public debt. Secondly, because there is the risk that, excited by past years' economic growth, we take things for granted. The economic requirements of the European Union are very high, and Romania has not always answered by performance. It is true, we have succeeded in reducing the public deficit, restraining the weight of the state sector in industry. These are accomplishments that add to continuous economic growth and cut of inflation. Nevertheless, we still have to pass even more difficult exams: increasing productivity and efficiency, reducing corruption and bureaucracy, contractual discipline, wage policy, improving the unitary labour costs etc. - in a nutshell a truly functional market economy in Romania.

(translated into English by Ioana Mureșan, EIR)

NEW AND FUTURE MEMBER STATES - WHAT COULD BE THEIR ASSUMED ROLE IN A 27-MEMBER EUROPEAN UNION?*

Mihai-Răzvan Ungureanu**

The topic chosen for our discussion today is indeed one of great interest. I would start by welcoming our hosts' intuition, one that challenges us to analytically assess who we are and where we are heading to, in a certain context in which Europe, after the French and Dutch referenda on the European Constitution, is concerned with the present and future of its architecture. We are passing, for sure, through an introspection momentum, a time to evaluate the European role and targets, a time to ask for constructive approaches from all European leaders and for vision necessary for solving this intricate puzzle we name European Union.

The remarkable dynamics of the last weeks proved that the European citizens are concerned with one question: "Quo vadis Europa?", and try to find answers and to influence all political leaders' steps. We saw how important it is that, in order to enjoy peoples' support, the European project has to be presented in a convincing manner and explained properly while answering, at the same time, in a flexible and responsible way, to the signals of the public opinion. It is also extremely important for such a project not to be perceived as a far too distant one, which highly complicates the European scenery, but, on the contrary, as a project bringing the Union closer to all its citizens.

A vote on the European Union constitutional project was bound to unleash, as reflexes for every citizen, not only introspections on the political future of the Union, but also verdicts on the manner in which the European construction responds, nowadays, through national governments' actions, to the legitimate security, prosperity, and identity expectations. Thus, the French and Dutch referenda stressed the relevance of initiating a substantive debate, which could transcend the institutional framework of the Constitutional Treaty. This is exactly what some European leaders expect from the European Council of 16th and 17th of June.

At this point of the European construction, the Union has to find answers for the challenges represented by the need for improvement of its internal mechanisms and the future performance of its institutions, as well as by the delineation of its politics, in order to create a more democratic, more powerful Europe, closer to its citizens and able to assert its role on the global arena.

This is certainly an important time also for Romania, who's getting into the final phase of the accession to the European Union, after the signing of the Treaty. Our country is concentrating all its strengths to successfully finalize the process of

* Speech delivered by Mr. Mihai-Răzvan Ungureanu, the Romanian Minister of Foreign Affairs, at the 5th Anniversary Conference of the European Institute of Romania: "NEW AND FUTURE MEMBER STATES. HOW TO ACT IN EU-27?", held in Bucharest, 8th 10th June, 2005.

** Mihai-Răzvan Ungureanu was appointed Minister of Foreign Affairs on December 29, 2004. Prior to this appointment, he was deputy coordinator for the South-East European Cooperation Initiative (SECI), Vienna. He served as State Secretary with the Ministry of Foreign Affairs (1998 - 2001) and Director General - Regional envoy of the Stability Pact for South-Eastern Europe (2001-2003). In 2004, Mihai-Răzvan Ungureanu became Dr.Phil. of Faculty of History, "A.I.Cuza" University of Iasi.

accession and to promote the Treaty ratification by all Member States. We will join on January 1st, 2007, and we are highly interested in Europe's future, in our role and added value to a 27-member Union, in the manner in which we will promote our national interests and contribute to strengthening the European Union.

It is time, right now, to stress that, from a political and judicial point of view, there is no conditioning between Romania and Bulgaria joining the European Union and the European Constitution endorsement. We are talking about two separate processes, with a well-formalized dynamics. Obviously, we are very interested by the institutional structure and the functional mechanisms of 2007 Europe.

Through this perspective, we are directly involved, as candidate country and observer to the Union institutional activities, in accomplishing the European Union goal of building powerful, representative, and more democratic institutions, able to facilitate cooperation in a broader framework. The European Constitution (and Romania contributed, as an active observer, to its completion and adoption) fully suits the EU objectives and we certainly hope that the necessary solutions are found, so that the European Union fulfills its designed role, following the decision of the other member states.

The contribution of the 10, soon to be 12 new Member States, to the communitarian construction is thus placed among the challenges of redefining the European identity in an enlarged Europe.

The new and future Member States bring to the Union, first and foremost, a profoundly symbolical message, the message of peace, of creating a European

climate auspicious to a genuine fulfillment of the European unity. Given the background of the traumas left behind by the communist era, corroborated with the war period which preceded them, the new Member States are looking to reach a certain solidarity based not on an abstract notion of the importance of peace, but on a new kind of solidarity, a real one, based on the efficiency of democratic institutions and on the consolidation of the free market.

This message represents also the main catalyst of the Union enlargement and the new Member States desire to play a decisive role into further taking this process, so that the European perspective, as a stability and development generator, will be extended beyond the new European Union borders.

In order to face future challenges, such as terrorism, poverty, economic and social discrepancies, the European Union has none but one simple solution: strengthening the European construction. Only a single-voiced Union could represent a real example at global level, and this is exactly the way in which Romania understands and is willing to contribute.

The new and future Member States must play a special role in revitalizing the Laeken Declaration objectives, and in strengthening the solidarity among EU Member States, through a contribution to grand political initiatives, such as The Lisbon Strategy or The Hague Program on consolidating freedom, security and justice in the European Union.

One of the Laeken objectives is to substantiate, through different means, the communication between the European institutions and citizens. This objective became one of the sine qua non

prerequisites for advancing the European construction, taking into consideration the fact that the most important EU actions and aims were not, lately, properly explained to its citizens. Lacking efficient communication, people will only see in further EU construction an obstruction to their interest as individuals.

Thus, EU proximity to its people, as well as the sense of solidarity developing among all European citizens, constitute major tasks at the Union level and some of the most important objectives of the new Member States. We have to build a common understanding climate and a true partnership among Member States citizens, and also a climate favorable to the communication between citizens and EU institutions, functioning in the interest of creating the European common good.

As future member of the EU, Romania is interested in transferring democratic values to the near-by areas (the Western Balkans and the Eastern Neighborhood), thus contributing to ensuring stability and

security on the entire continent. In this way, we are working in all regional or international organizations that we are part of (such as UN, NATO, SEECP, Stability Pact, BSEC) to encourage the efforts of the states in the Western Balkans and in our Eastern Neighborhood to get closer and to integrate the European and Euro-Atlantic community.

Out of our own experience, we believe that the European perspective represents the proper catalyst for accelerating all required reforms and consolidating the democratic processes.

Therefore, our integration goal is a double-ended one: we want to spread our solidarity towards regional states with European aspiration, as well as to generate positive developments in the European Union, beneficent to all 27 actual and future Member States' citizens. Romania wants to become a fully functional and efficient country in a more functional and more efficient European Union.

THE ACCESSION BETWEEN CONSTRAINTS AND OPPORTUNITIES*

Mircea Geoană**

It is an honour and a privilege to be here with you and briefly elaborate on such a hot and challenging topic - the accession and Romania's profile as a future member state. The task is even more challenging as the debate is taking place under the auspices of the fifth anniversary of the European Institute of Romania, the activity of which I highly appreciate and support.

We are now very close to reaching our integration goal. We closed the negotiations and we have signed the Accession Treaty in Luxembourg. We are trying to get full advantage of our observer status in the European Council and, as of September, we will have 35 observers in the European Parliament too.

The recent estimations regarding the outcome of the first wave of the 5th enlargement are quite optimistic as well. Before May 1st, 2004 pessimists warned that the enlargement could lead to political and economic disaster because of the important gap between the Eastern and Western European Countries.

After one year, although new and old members still face political and economic challenges, the emerging trends are very positive. In economic terms, the gains are clear. The new EU members saw gross domestic product rise 5 per cent last year and the economists forecast a further increase of more than 4 per cent in 2005 - more than twice the rate of the EU 15.

Accession has boosted trade. Imports and exports between the EU 15 and EU 10 have risen substantially since accession. In fact, the benefits of enlargement for the EU 15 have been felt for over a decade, as the volume of Euro-area exports to the new member states increased 140%.

As enlargement has boosted foreign direct investment generally in the EU 10, companies from the 15 old member states are among the biggest investors. Austria, for example, is now the biggest foreign investor in Slovenia, Romania and Bulgaria and the third biggest foreign investor in Hungary, Slovakia and the Czech Republic.

Looking at the big picture, the estimates are for EU enlargement to increase gross domestic product for the EU 15 by 0.7 per cent over the next decade.

Just as important as the positive economic trends is the fact that none of the predicted disaster scenarios have happened, not the un-precedent surges of cheap imports, the mass migration flows or the health scares from substandard food.

Tourists are flocking to the region and students and young people from the 10 new member states have seized the opportunity to travel and learn languages abroad.

Therefore, at least in theory, we have a lot of reasons to be optimistic about our accession in 2007.

* Speech delivered by Mr. Mircea Geoană at the 5th Anniversary Conference of the European Institute of Romania: "NEW AND FUTURE MEMBER STATES. HOW TO ACT IN EU-27?", held in Bucharest, 8th - 10th June, 2005.

** Mircea Geoană is the President of the Social Democrat Party and President of the Foreign Policy Committee of the Romanian Senate. Former Ambassador of Romania to the United States of America (1996-2000), and former Minister of Foreign Affairs (2000-2004).

Reasonably speaking, we should not forget that Europe is facing today a number of important challenges: to maintain the competitive edge of its internal market, to continue to provide internal security, stability and economic growth, to be strong enough to face the new threats to international security, to strengthen the transatlantic link, to forge a balanced partnership with the other major world powers. Last but not least, the negative vote on the Constitutional Treaty in France and in the Netherlands is the expression of a profound crisis of the European project, maybe the most severe it had ever witnessed.

I took part, in France, at several public manifestations organised by the supporters of the Constitutional Treaty and I was very surprised to discover that the major part of the population had not the slightest idea about the provisions of the Constitution. The negative vote was a hundred percent the reflection of the public dissatisfaction regarding the internal socio-economic context. It was a vote of mistrust given to the political class in power. But the result is affecting the whole European architecture. The Constitutional Treaty is now buried for at least two years because of the autumn elections in Germany, the Italian elections in spring next year and the French elections in autumn 2006.

The negative vote on the Constitutional Treaty and the European political crises it triggers could also put into question the enlargement process and we shouldn't be surprised if Romania's and Bulgaria's progress is even more carefully evaluated. Thus, Romania could turn into a genuine Nadia Comaneci of Europe. In a

tense European context, any mistake in its performance could be severely sanctioned.

In order to achieve full membership on the 1st of January 2007, we have to successfully overpass three very important events: two Commission Comprehensive Monitoring Reports - one in October this year and the other in spring next year, and to have our Accession Treaty ratified by all 25 member states in due time.

We legitimately enjoyed our moment of glory in Luxembourg, while signing the Accession Treaty, but it's time now to get back on Earth and focus more on the implementation of the commitments assumed during negotiations. And there are a lot of sensitive issues to concentrate upon: the reform of the judiciary, the fight against corruption, strengthening border control, combating illegal migration and traffic in human beings, health and social reforms, ensuring fair competition rules and creating a friendly environment for business.

Although very important, the strategic partnership with the US or the integration in the international structures of our eastern neighbours is not the main objective of our internal and foreign policies. We should not lose sight of the fact that the main goal of Romania is the integration in the European Union on the 1st of January 2007. Exclusive Atlanticism will not bring us in the EU, as our President seems to believe.

Our European partners are evaluating not only the internal reforms, but also the overall behaviour of the political actors. Since Europe is not just an internal market, but also a community of people sharing the same interests and values.

THE EUROPEAN CONSTRUCTION - RECENT CHALLENGES*

Ene Dinga

It is a great pleasure and an important opportunity for me to be able to ponder, together with all of you, upon such a complicated and challenging issue, like the future of the European construction pattern.

We are privileged to witness a situation that calls for the review of the philosophical value foundations of the European proposal on a cultural, institutional, political and social-economic construction. But this privilege comes with a huge historic responsibility, since the offer that Europe makes to the entire world from now on depends on the manner and quality of our present assessments.

Obviously, the stage we find ourselves at in the European construction is the result of some accumulations of internal processes of the European pattern, in relation with the external environment, generated by alternative patterns, opposable to the cultural and civilisation European pattern. Pending our intervention, we will focus upon the internal causative factors.

From the very beginning we will state that the stage the European pattern finds itself at is not a turning point but a modulation on. Europe is not in a crisis, but in a moment of reconsideration of its path, namely a global reconsideration, which is directed to its foundations. We find ourselves, most probably, in a situation that calls for an honest, but trustworthy reviewing of the intellectual project that has generated the great European construction.

It is obvious that the inflexion point mentioned above is a growth effect. In other words, the evolution of the European model needs a moment of self-assessment, of self-reflection. The Constitutional Treaty rejection by France and the Netherlands, as relatively sombre perspectives generated by the recent declarations concerning the viability of the European pattern as a whole or the collapse of the Euro zone, doesn't stand for nothing, but some occasions to manifest some latent, deep causes.

I would remark the divergence as one of these fundamental causes, and a pretty strong one, between the interest on the national problems and that on the European problems in general. In France, the vote against the Constitutional Treaty represents a peremptory expression for that, but as we were saying, it is only a surface phenomenon. Let's, for example, remember, that the Growth and Stability Pact was modified, in order to legitimate its non observance by the founding member states, generating a feeling of common rules instability (but this alteration was generated by the functioning elements of some national economies, as those of Germany, France or Italy).

The negative vote for the Constitutional Treaty and the discontent with the national Governments has moved towards the European issues whose ideals were rejected.

Another important cause can be

* Speech delivered by Mr. Ene Dinga, former Minister of European Integration, at the 5th Anniversary Conference of the European Institute of Romania: "NEW AND FUTURE MEMBER STATES. HOW TO ACT IN EU-27?", held in Bucharest, 8th - 10th June, 2005.

identified in the gap created between the “eurocrats” (initiators of the systems, mechanisms and institutions at the European level) and civil society, which means between the leadership's offer and the expectations of the citizens. I would like to add that it is not an isolated incident of inefficient communication (although an inefficient communication can be interpreted as a deep cause), but a much more important problem: the problem of the promoted values, values that can shape the future direction for the European architecture in the years ahead.

Let us remember that the Constitutional Treaty was not the only strategic document of the EU, in which the liberal feature prevailed over the social values. The review of the Lisbon Agenda determined a concentration of all efforts towards development of the member states in accordance with the more liberal values.

It is arguable, of course, if such an extended, complicated, heterogeneous system, from the cultural point of view, can be sustained without a firm, general and steady support of the citizens.

It is possible that globalisation, as an inexhaustible process, will not diminish the importance of the social factor over our models of development, but, on the contrary, increase it.

Of course, the present situation will generate intense debates, some of them excessively politicised, but most of them, honest and devoted to the effective and durable relaunch of the European culture and civilization model.

It is my conviction that, besides the two causes presented above, another one should be discussed, particularly the model for economic growth that the European

Union wants to establish: the present point requires a radical change of paradigm in the field of economic growth. The wish to achieve and to overtake the American model of economic growth (presented in the initial form of the Lisbon Agenda) is unrealistic, especially in the era of globalisation and in the negative trend regarding the available assets of natural resources. The unrealistic character of the Lisbon Agenda derives from the method of achievement and not from the ambition of the established purposes: it has to waive the paradigm of growth based on optimal behaviour and it has to be accepted the paradigm based on sustainable behaviour. We should not be interested in the optimal values for the economic variables, but in the sustainable values of these variables. In this case, the objectives of economic growth should not be established in a comparative model, the exogenous way (in comparison with the American economic growth model), but in the endogenous way: the consistency with the compels of the own system on long term. I believe that the disappointment of some member states regarding the European project (and also the pessimism expressed by some analysts and politicians) is overwhelmingly caused by the unrealistic capacity of the European Union to address the economic challenges, especially at the level of the review of the Lisbon Agenda objectives: growth, productivity and occupation.

I would like to shortly discuss about the comparison between the horizontal enlargement of the European Union and the vertical enlargement (institutional enlargement). There are a lot of people who consider that after the rejection of the Constitutional Treaty by a few member states, the present European model is in a crisis, following the process of potential

implosion generated by the incapacity of the institutional developments to sustain the enlargement of the European Union.

In my opinion, although the necessity of simultaneous development on the two directions that I have mentioned before must not be excluded, this is a false argument for the following reasons:

a) The horizontal enlargements are themselves, broadly speaking, institutional developments because they involve various improvements at the level of mechanisms, procedures, etc. Therefore, the development of the European Union on the two directions is not accomplished in a geometrical manner, but in an organic one.

b) The horizontal enlargements have always been preceded by the creation of institutions able to manage these enlargements (for example, the horizontal enlargement with Romania and Bulgaria it is stipulated, from a vertical point of view, in the Nice Treaty)

c) In a more general way, it is known that, within the social construction, the

targets provide themselves quite frequently their own sources. In other words, let's say that the tension created by a new horizontal enlargement is capable to generate, in a specific way, the ad-hoc institutional resources for the management of the newly created situation. For that reason, one of the most efficient concept of public management at the level of European Union is, as we all know, the one that says: "policy before resources";

d) The horizontal enlargements bring added value to the Union. This is one issue envisaged by the European Commission when new horizontal enlargements are negotiated. The fulfilment of the accession criteria by a candidate country or by a country in the process of accession (as Romania) has two expected effects: 1) achieving the minimal parameters which will prevent the shock of the accession; 2) bringing added value to the Union, at all levels of negotiation. Or, bringing added value is an element for institutional deepening.

THE EXPERIENCE OF THE NEW MEMBER STATES*

Kazimierz Sobotka**

As concerns Poland's experience acquired during the first year of membership in the European Union, I must say that, in general, the accession to the EU appears to be favourable both for the country and for the citizens. The majority of the society also evaluate positively the results of the first year in the EU and both macro and micro economic indicators persuade us that on the May 1st, 2004 Poland started a new period of its history, a period of accelerated development and modernisation.

To illustrate this, I would like to present some general information and statistics as well as public opinion pools results on Polish membership in the EU and, last but not least, the Polish standpoint vis-à-vis the Constitutional Treaty which is now, after the referenda in France and Netherlands, lively discussed all over Europe.

The date of Poland's accession to the EU was accompanied by hopes and fears linked with its prospective results. According to analyses and prognoses made before our accession, it was not sure that it would be successful from the financial point of view. Some euro sceptics bluffed that Poland would be net contributor to the EU budget. Simultaneously, among the biggest pessimists were the farmers who were afraid

that accession was not positive for Polish agriculture, which would have to face competition with more modern and subsidized agriculture of the EU old Member Countries.

After one year of membership we can say that, most probably Poland will be net payer, because it proved to be well prepared to absorb structural funds. Also against the previous prognostics, Polish farmers became the biggest winners - not losers - of the country's membership. Against the fears spread among farmers, foreign cheap food did not flood the Polish market but vice versa - the Polish agricultural products massively invaded the neighbour countries markets.

This fact seems even more striking as such situation was not expected before. A few years ago, I participated in a research financed by the World Bank and coordinated by the Institute of World Economics in Budapest and devoted to the estimation of the effect of the Central and Eastern European countries accession to the EU on their social groups economic situation. The title of the research was "Winners and losers of the EU integration"¹. According to a common opinion shared by the researchers, small farmers were to be the biggest losers of the European integration.

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¹ *Winners and Losers of European Integration*, World Bank, New York 2000.

Today, we have been rather to our satisfaction than dismay persuaded to admit that we were not right.

Let us present now some figures to illustrate the economic effects I talked about so far in general².

1. In 2004 the GDP reached the level 6% and it was the best result in the last 7 years. In 2005, probably, it will be a little bit less than 5%.

2. Export also increased: especially to the EU countries and Eastern neighbours. The biggest increase we can note in the trade with Ukraine (by 30%) and with Russia (by 89%). It was the profit taken from the participation in the bilateral agreement provisions between EU and Russia as well as the result of subsidies for exports of food to non-EU countries.

3. The investments increased by 50%.

4. Polish currency became stronger in relation to Euro and US Dollar. In April 2005 the exchange rate to Euro was 3,98 PLN and 3,06 PLN to US Dollar.

5. However, if we present positive results of the first year's membership, we must also present negative ones as they did appear. Then, against prognoses from before our accession, the prices of foodstuffs increased. It was, among others, the result of the rapid increase of demand for the Polish groceries from the EU consumers. This phenomenon caused also the increase in inflation rate which increased from 2,2% in April 2004 to 4,4 - 4,6% after 1st of May 2004. The increase of inflation rate was the result of the increase of prices of food after the 1st of May 2004 (in some assortments of meat even by 100%).

6. I have already mentioned that pessimistic prognoses prepared before the accession had foreseen that Poland would be net payer to the EU budget. In reality, in 2004 the balance within financial transfers between Poland and the EU budget was 1 554.083 million EUR in plus. In 2005 Poland will receive additionally 560 million EUR from the Norwegian Financial Instrument and European Economic Space Aid. In total, financial transfers, by the end of 2006, will reach 11 billion EUR. Polish farmers will receive, beyond the direct payments, 1,4 million EUR within financial support for exports of agricultural products.

7. Talking about fears and hopes of the Polish society vis-à-vis the accession we should mention the biggest problem the Polish economy is facing. I mean here unemployment: its average rate is 18%, but it did not increase. The accession did not result in its decrease, but by the end of 2005 about 600.000 Polish citizens will be employed outside the country. The major part of Poles looking for employment abroad finds it in the United Kingdom.

Talking about results of Poland's membership in the EU we cannot forget about its political aspects. In foreign policy within the EU, Poland's priority is to support the membership of the Eastern European countries. Thanks to Polish and Lithuanian efforts, in December 2004, the European Council pronounced a special declaration for Ukraine stressing the strategic importance of Ukraine as the key partner of the EU and the "key neighbour" of the Community. The EU wants to establish close and privileged relations with Ukraine. Poland would support preparation for opening of the negotiations with Ukraine

² The figures have been taken from: *Polska w Unii Europejskiej (Poland in the European Union, The experience of the first year of membership)*, Urząd Komitetu Integracji Europejskiej (Office of the Committee of the European Integration), Warszawa 2005.

and Moldova. Concerning Belarus, Poland's standpoint is not to isolate that country because of antidemocratic regime of Lukaszenko, but to start a constructive dialogue. Poland's involvement into "the Orange Revolution" resulted in cooling the relations with Russia. We must stress that Poland is not "anti-Russian" country. It wishes to build with Russia partnership relations based on equality and mutual respect.

As far as the political relations inside the Union are concerned, the attitude vis-à-vis the Constitutional Treaty seems to be important. With generally positive assessment of the draft Constitution, Poland raised major objections only against a few provisions of the Constitutional Treaty, namely: the number of Commissioners, the question of potential defence cooperation vis-à-vis NATO, Christian heritage clause and the new voting system in the Council.

As regards the number of Commissioners, Poland advocates the rule „one country one Commissioner” together with the equality of rights.

Another question raised not only by Poland but also by some other countries was the question of Christian heritage clause in the Preamble. As the inclusion of *Invocatio Dei* could not be accepted by the Europeans who are non-believers, a clause referring to the role of Christianity for European heritage and identity corresponds with historical truth. The Polish position stresses the historical truth, the one beyond doubt. These are the facts and one should not argue about them. One can only forget or ignore them. It seems that while discussing the Preamble, one should be aware of the existence of a clear-cut borderline between

Central-Eastern European countries and Western ones, as in the struggle for human rights and freedom in the East, in 19th century, religion and the Church turned out to be an ally. The same phenomenon could be observed in the communist era. The western struggle for freedom in the 19th century was the struggle against the Church, the one involving wide societal circles. As a consequence, laicism and atheism are more popular in Western Europe than in its Eastern part.

It seems rather understandable that among the problems raised at IGC by Poland the key one was the question of weighting of votes at the Council of Ministers. As the position of the Polish government is quite well known, I will present only one Polish argument against the new system proposed by the Convention, which seems to be most convincing.

Polish standpoint is that the new constitutional voting system would be less favourable for small and medium countries. Small countries would be the major losers of the new voting system in the Council - if we take into consideration the possibilities of making coalitions. From this point of view, France and Germany as well as 6 founding countries would be winners while Spain, Portugal, Greece and 12 new members would be losers³. So, from the point of view of the possibility of making coalitions, the new voting system introduced by the Convention is not beneficial for small and poor countries, which are interested in receiving bigger financial assistance from the EU budget. In the view of the above, if the richer countries were to scrub structural assistance, the poorer countries would have no tools at their disposal to prevent it unless

³ Rafał Trzaskowski, *The shape of the Eu beyond enlargement after Convention [in:] "Convention on EU Reform and Enlargement",* (ed.) Maria Karasinska-Fendler, European Institute, Lodz, 2003, p.p. 66-67.

12 new members grouped with the current 3 poorer states their population will not reach the necessary size of population but they would represent the majority of states.

We must agree that the new system of weighted votes is more transparent and easier to understand, but we must also note that it strengthens the power of bigger and richer states, which would have decisive voice in the decision-making process. For the ordinary European citizens it does not matter so much if the voting system in the Council, which is not elected by them, is easier or more difficult to comprehend. Apart from this, citizens of the new member states took their decisions in the referenda mostly on the basis of the different Nice Treaty. Finally, we agree that double calculation is less complicated than triple, but the latter is not impossible to understand and put into practice.

Independently from that, Poland's membership in the EU resulted in the increase of the society's support for the accession and the increase of optimism among the Polish citizens. Generally speaking, Poles are pessimists. If you ask anybody to express his or her opinion on his/her life conditions and economic situation he/she will complain that everything is getting worse. But if we analyse their economic behaviours, measured with bank credits, new business initiatives and purchases, Poles will prove to be the biggest optimists in the EU. The high levels of popular support for membership of the EU increased after the first of May and in February 2005 they reached the level of 72%.

IMPLICATIONS FOR THE ACCESSION COUNTRIES OF THE REJECTION OF THE EU CONSTITUTION*

Georges de Menil**

The rejection of the EU Constitutional Treaty by the French and Dutch electorates has profound implications for the European Union, its existing members and its accession candidates. The two referenda indicate that public opinion in Western Europe is more wary of deeper European integration and more anxious about enlargement than had seemed the case in the euphoria of May, 2004. The leaders of the existing Union are, therefore, likely to proceed more cautiously on both fronts. In some cases, accession will be postponed, in many the doors to immigrant workers will be partially closed, in all, structural funds in support of accession risk being reduced.

This paper will address two implications of the May/June 2005 referenda for the accession countries which are the closest to entering the Union. These countries have no alternative but to continue to pursue accession as an overriding priority. First, I shall argue that what the changed circumstances call for in these countries is a renewed commitment to policies of market opening and structural reform. Whether the objective is to catch up with a missed deadline, or to ensure successful integration, the aggressive pursuit of enhanced competitiveness is an even higher priority than it was before May/June 2005. My second point will be that the

Union will be an unfinished project when these countries enter, and that they should prepare to engage actively in the cooperative effort to complete the construction.

1. The importance of pro-market reforms

In Romania and elsewhere, analysts of accession frequently weigh the benefits versus the costs of integration into the Union¹. A moment of economic reflection suffices to demonstrate that the potential, long-term benefits for the accession country are at least of the order of magnitude of the current level of GDP. When a country in which the average monthly wage is 150-200 Euros integrates a region in which the average monthly wage is 2000 Euros or more, the forces of convergence are such that, not instantly, but in a limited number of decades, the real wage in the acceding country has the potential to catch up with the real wage in the larger region. That means, by itself, a potential for the labor share of GDP roughly half of the total in most accession countries to increase ten-fold, over time. Even if one discounts for the decades the convergence will take, this implies that the present discounted value of the benefit of integration is roughly equal to current GDP².

* Prepared from remarks at the 5th Anniversary Conference of the European Institute of Romania: "NEW AND FUTURE MEMBER STATES. HOW TO ACT IN EU-27?", held in Bucharest, 8th - 10th June, 2005.

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¹ See, for example, Ciupagea et al. (2004). They compare the benefits of accession in 2007 with accession in 2009/2010, and find earlier accession preferable.

² If the average duration of convergence is 30 years, and the discount rate is 5%, a five fold multiplication of real GDP i.e. a 400% increase – is roughly a 100% increase in present discounted value.

How does this potential benefit compare with the cost? The costs of integration into the European Union are of two different kinds: direct, budgetary costs, on the one hand, and transitional, structural adjustment costs, on the other. The budgetary costs include contributions to the EU budget, and the costs of catching up to EU standards, as regards infrastructure and the environment. It is reasonable to assume that, during most of the convergence period, accession countries will be net recipients rather than net contributors to the EU budget. (Their direct contributions will be compensated for by subsidies from the EU's structural funds and from the Common Agricultural Policy.) Investments in infrastructure presumably pay for themselves over time. The costs of catching up to environmental norms are, however, a net burden to the economy. The World Bank has estimated that these environmental clean-up costs may reach 2% of the GDP of the accession countries for a number of years. If they are 2% for ten years, the present discounted value of the total environmental clean-up cost will be 16% of each accession country's initial GDP³.

There remain the transitional costs of structural adjustments principally the time spent in unemployment by workers and managers laid off in inefficient plants and uncompetitive industries. The magnitude of these costs is difficult to estimate. They are likely to be concentrated at the beginning of accession, and to be born by the public at large, rather than by the owners of the new and expanding firms. They are therefore a legitimate matter for public concern. But they are bound to be a fraction of the present discounted value of the potential gains. If

unemployment were 10% higher than it otherwise would have been for five years, the loss in the present discounted value of labor income would be less than 25% of GDP⁴. Adding these transitional costs to the costs of environmental clean up, one obtains an upper estimate of 40% of GDP for the present discounted value of the total cost of integration into the EU. These illustrative calculations suggest that the ratio of potential, long-term benefit to cost could be two or three to one.

However, in order to realize this net benefit, the accession country must be competitive. If its leaders view integration into the EU as an opportunity to receive subsidies that will allow them to postpone painful adjustments, the country is more likely to stagnate than to experience rapid growth. This is all the more true in the likely present context of tighter EU budgets.

The lessons of earlier enlargement experiences are informative, in this regard. The most interesting examples for Romania are those of the accession of Greece (1981), and Portugal and Spain (1986)⁵.

There are common threads with some similarity to the histories of the formerly Soviet countries in political developments in the three countries prior to accession. The collapse or overthrow of authoritarian regimes the generals in Greece, Salazar in Portugal and Franco in Spain opened the way to membership in the EEC. But the domestic economic policies implemented by the leadership of these countries after accession were markedly different.

In Portugal and Spain, new democratic governments, freed prices,

³ This assumes, again, a real discount rate of 5%.

⁴ By reducing labor income, the additional unemployment mechanically reduces GDP by roughly 5% each year. Discounted at 5%, the present discounted value of that reduction is 22.5% of GDP.

⁵ Ireland has made a remarkable success of accession, but its size and its language advantage make the example less informative for Romania than the other three.

opened trade, and denationalized and deregulated industry⁶. In Greece, the new democratic government pursued a populist program, imposed price controls, nationalized industrial firms, increased social spending and incurred large budgetary deficits, new taxes on capital notwithstanding. In the eyes of one analyst, Greece, rather than seize the opportunity presented by accession to increase competitiveness, used the structural funds it received to postpone needed adjustments.⁷

The result was that the Portuguese and Spanish economies boomed in anticipation of and after accession, whereas Greece's economy entered a twenty-year period of stagnation, which was not reversed until policies changed, and budgetary consolidation, fiscal cuts, and regulatory reforms were implemented in the lead-up to Greece's entry into the European Monetary Union in 2000.

One number which captures the difference in the economic climates of these countries is the ratio of total fixed investment to GDP. In both Portugal and Spain, fixed investment grew at double-digit rates during the accession year and the two following years. As a result, the ratio of investment to GDP climbed in both countries, even though GDP was also accelerating. By contrast, in Greece, the ratio of investment to GDP, which had temporarily risen after the fall of the Generals, was stagnating at the time of accession.

Graph 1 tells the story⁸. One sees

there that, in Portugal and Spain, the ratio of fixed investment to GDP, rose 20% above its accession level in two years, and then remained high. By contrast, in Greece, this ratio was at its highest-level two years before accession, and fell steadily thereafter.

The consequences for GDP of the differences in business climate, and the differences in investment intensity just described, are more dramatic. Graph 2 shows that, whereas GDP rose steadily in Portugal and Spain before and after accession, in Greece, it stagnated for years. The consequence was that, by the time the European Monetary Union was launched in 1999, Portugal, initially the poorest of the three, had erased half of the gap between its GDP per capita and the EU average. Spain, better off in 1986, had also eliminated close to half of its smaller gap. Greece, in almost twenty years, had not significantly changed its relative position. See Table 1⁹.

What are the lessons of these three examples for Romania? The reforms which the Portuguese and Spanish governments implemented in the 1980s have already been implemented in Romania. Foreign exchange was decontrolled, prices were liberalized, directed credits were essentially discontinued, and large scale, industrial and financial privatization was launched during the period of the Coalition governments of 1996–2000. What Romania needs now is a second wave of reforms, with an emphasis on the liberalization of business regulations, the liberalization of the labor code, and the development of financial markets, notably

⁶ For details on Spain, see Blanchard and Bentolila (1990); on Portugal, OECD Portugal country reports; on Greece, Alogoskoufis (1995). Some observers deem domestic policies in Portugal to have been more market friendly at the time of accession than domestic policies in Spain. See Bean et al. (1998), pp. 64-67, who emphasize the costs for Spain of its rigid labor-market regulations. But the difference between policies overall in those two countries in 1986, and policies in Greece in 1981 is like night and day.

⁷ See Alogoskoufis, *op. cit.*

⁸ The data are taken from World Bank (2005). By normalizing the ratio with respect to its value in the accession year, one eliminates much of the effect of the structural differences between these economies.

⁹ The numbers in Table 1 are also taken from World Bank Development Indicators.

through the enactment of private pension reform.

Romania's first wave of reforms was implemented under extremely difficult external circumstances. The East Asian crisis in 1997 and the Russian default in 1998 dried up incipient global demand for investment in transition countries, and caused the IMF to retrench and insist on difficult, if not unrealistic, conditions for Stand By renewal¹⁰. The following year, the war in Kosovo reduced exports and put a further damper on FDI. In spite of these negative external conditions, and of the burden of internal political conflicts, the first wave of reforms was successful. After a sharp, initial transition recession, output began to turn around in 2000. The liberalizing reforms of 1997-2000 laid the foundations for the steady growth of the subsequent four years.

Circumstances would be otherwise supportive if accession into the EU was preceded and accompanied by a second wave of reforms. By improving Romania's competitiveness, these reforms would allow Romania to take full advantage of its enhanced access to the Single Market. The combination of expanded access and liberalizing reforms could be a potent recipe for increased growth.

2. Preparing to participate in the construction of Europe

When Romania accedes to the European Union, the Union will still be a work in progress. The key problems of governance in a Union of 27, which the Constitution was intended to solve, are unlikely to have been solved by then. Two stand out.

- The European Council must be able to act. Under current operating rules, established in the Treaty of Nice, decisions which require a qualified majority vote (QMV), can only be passed if three conditions are simultaneously met: The decision must be supported by more than half of the Member States, with 72% of the weighted country votes, and 62% of the EU population. Experts estimate that the conjunction of these conditions means that, in a Union of 27, only 2% of all proposals are likely to be passed¹¹. This is tantamount to gridlock. The European Council will be almost incapable of taking a decision on any subject. The EU Constitution would have simplified this procedure and radically improved the capacity of the Council to take decisions. If the Member States want to avoid gridlock, they will have to find another simplified procedure with a lower threshold. Reducing the threshold does not necessarily require changing the allocation of weighted votes. A revival of the rule proposed in the Constitution (55% of the countries and 65% of the population) would require changing the relative positions of Poland, Spain, France, Germany, and others. In the present context of caution which the rejection of the Constitution has created, that may not be possible. Lowering the threshold without changing the relative weights may be a feasible compromise.

- Opinion polls suggest that the electorates of France and the Netherlands are not the only ones to chafe at what they perceive to be the democratic deficit of Union institutions. If they ignore these frustrations which, technically, they can, since citizens do not yet have a major formal voice in Union decisions the leaders of

¹⁰ On the "bail-in" conditions the IMF wanted initially to impose on Romania in 1999, see Stiglitz (2002), chapter 7.

¹¹ See Baldwin and Wyplosz (2004), Chapter 3, and the references cited there.

Europe risk precipitating a popular crisis of legitimacy, which could, in fact, paralyze Union actions in the future. Addressing the demand for democratic accountability is therefore necessary and urgent. The Commission is the brunt of the greatest criticism in this regard, and the Parliament is the only institution inherently capable of channeling the desire for more democracy. Logic suggests that making the Commission more answerable to Parliament (than it is under the Nice Treaty), and increasing the codetermination powers of Parliament are feasible ways of endowing the institutions of the Union with more democratic legitimacy.

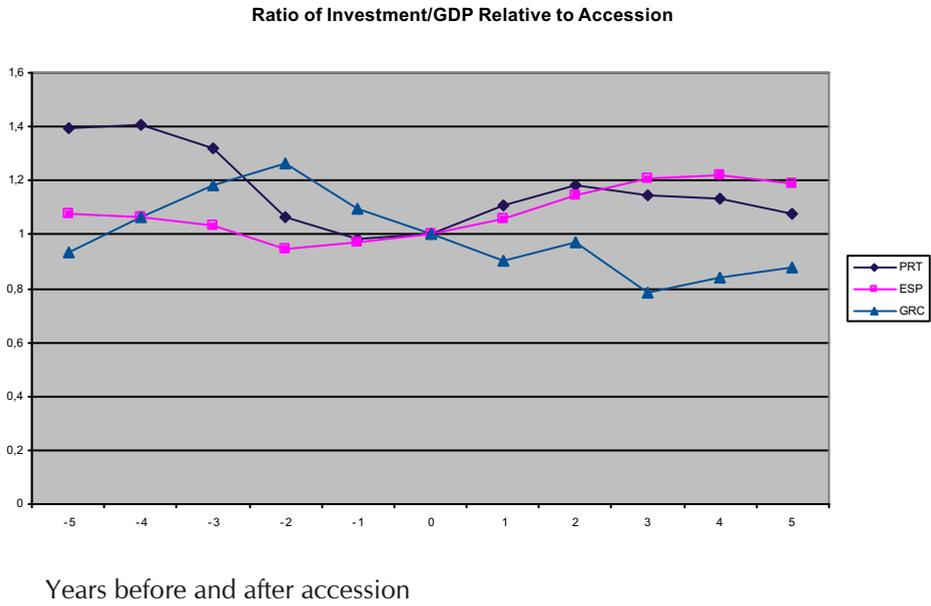
Forging an intergovernmental consensus on these two important matters in a Union of 27 members will be a daunting task. If the Constitution had been ratified, serious progress would already have been made on these issues by the time Romania entered the Union. The rejection of the Constitution is a serious setback. But the positive implication for Romania is that,

instead of inheriting a Union which is already constructed, it will have the opportunity and indeed be called upon to participate in the construction. If a Union of 27 is to endure, and to continue becoming a political entity which is more than a common market, Romania will have to live up to its responsibility to become, with its partners, a builder of Europe.

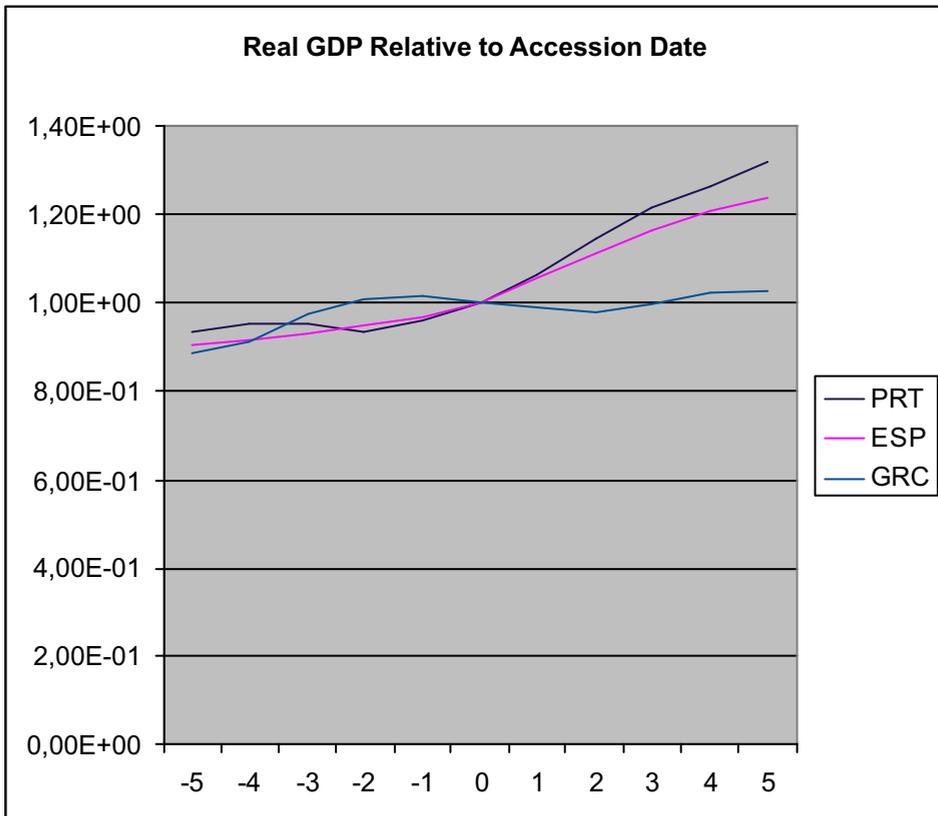
Conclusion

The two aspects of accession which I have emphasized the need for active, pro-market reforms, and the political responsibility of new members to contribute to the necessary deepening of the Union both highlight the fact that accession is not a road of passive entitlement, but an opportunity for constructive engagement. This was true before May-June, 2005. It has become more so, in the aftermath of popular rejection of the EU Constitution.

Graph 1



Graph 2



Years before and after accession

Table 1

GDP per capita
Ratio to average of Eu15*

| | Year of Accession | 1999 |
|-----------------|-------------------|------|
| Portugal (1986) | 0.55 | 0.75 |
| Spain (1986) | 0.71 | 0.82 |
| Greece (1981) | 0.65 | 0.68 |

*Note: Source is World Bank Development Indicators. GDP is measured in constant US Dollars at purchasing power parities.

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REFLECTION ON THE IMPACT OF ENLARGEMENT FOR THE EU INSTITUTIONS*

Aurel Ciobanu-Dordea**

There are two main reasons why trying to assess the impact of enlargement on the Union's political institutions might be too early and could lead to very provisional conclusions, that need another check some time later:

a) policy-making cycles in the European Union (elaboration, adoption and implementing policy measures and legislation) are quite long, and certainly longer than the time-span familiar for observers of domestic policy-making. Such length is explained both by the multitude of infra-national, national and supra-national players involved, the consensual nature of EU policy-making and the intricacy of relevant procedures. While the exact result of such a calculation may vary from an area to another, and even within the same sector, this author's assumption is that, „from seed to fruit”, a 3-year period is the minimum required.

b) the enlargement of the Union to Central and Eastern Europe has overlapped and intermingled with the deepening of the European integration process. It is genuinely difficult in most of the cases to draw a clear separation line between the two processes, although a very conventional view says that the former was triggered by the later. It is often hard to distinguish strains generated by enlargement from those generated by a forcible or unprepared deepening of the integration process: while the enlargement

is believed to lead to an end of the current type of structural policies, there is at least as much truth in the fact that these policies gradually became inadequate in the EU well before its enlargement. The same goes for the positive consequences: the Western European economic boom in the early '90s was believed to be generated by the finalisation of the internal market, while it is very likely - but marginally acknowledged - that a significant contribution was played by the opening up of the CEECs' markets to EU goods and services.

One might add, on a more subjective note, that there is also a serious caveat in such an enterprise: distinguishing between perceptions and reality, and putting populist claims aside. No matter how deeply embedded are certain ideas in the minds of possibly the overwhelming majority of public opinion(s) in Europe, and this may also possibly write the history of next years, if the reality behind perceptions is different, then the difference and its consequences should be noticed. It is widely believed that a EU-25 (and an EU-27 all the more that) will work in difficult conditions; it is actually so, but to a much lesser extent than predicted. However, who is to be blamed: those crowing at the gates of the „new Rome”, or those responsible of pre-enlargement reform? The children of political correctness, cherished nephews of dialectics, might be tempted to apply the

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rule of the thumb and answer: „both”. But is it really so?

The European Commission

Beyond its current weakness in the EU's institutional landscape, which is not due to the enlargement process, but to national capitals lack of enthusiasm, the Commission has succeeded a good institutional transition. A good integration of the members appointed in 2004 for a full mandate by the new member states was coupled with a balanced distribution of dossiers among “old” and “new” EU citizens forming its college. The incidents that, during the appointment process, have led to the withdrawal of certain candidates (Ms. Udre) and the reallocation of tasks for others (Mr. Kovacs) were in no way specific to the newcomers (Mr. Buttiglione's case is one in point). The Commission's internal political cohesion is even strengthened as compared to the previous college, presided by Mr. Prodi, as the clusters of commissioners do not exchange just information and coordinate only in a formal sense, but appear at least from the initial design to decide on policies that concern the portfolios of several of their members. Moreover, the commissioners from the new member states brought with them a fresh and more energetic attachment to the European integration project, as well as for the reforms required to safeguard its continuous dynamism (Ms. Grybauskaite). It is also worth noting that, while President Barroso might not be considered a fan of major issues on Europe's growth and competitiveness agenda (such as environmental protection and social policy), he had in other respects a good start as designated President; his resistance against the pressure of several national governments, in particular from big member

states to “shop” policy portfolios for their nominees and to push them in front as deputy-presidents of the college.

At medium and grass roots level, the insertion into the Commission's administrative machinery of the new officials brought more dynamism and has generally proceeded well. This sometimes means “well” in the past line of the Commission, which is not necessarily a good thing (the practice of political appointments at medium and top management level continued, and it will not stop until all member states will openly and permanently give it up).

The current situation of the Commission is though not a good one in political terms. This is not due to the enlargement, of which the Commission has been a major sponsor within the limits of its bureaucratic and, sometimes, innocent idealistic understanding of realities. Instead, such weakness, which do harm the long term interests of Europe, is generated by older, more structural and serious enough difficulties:

1. the extremely critical approach held about it by a large number of member states' governments. It is already a tradition for these governments to use the Commission as a scapegoat for the shortcomings of policies and legislation that are ultimately defined in Brussels not by the Commission, but by their own representatives. The Commission is defined as the embodiment of the Union's democratic deficit, while the institutions incarnating the Union of the states (the Council) and the Union of the peoples (the Parliament) and which should bridge the gap between ordinary citizens and the supra-national level refuse to do it (for various reasons and in various ways).

2. the absence of a framework-project for the near and medium-term future, which should not necessarily be grandiose (maybe to the contrary), but coherent, practical and achievable. The Commission's service in the definition and achievement of such a project would have redeemed its reputation and skills. The Union has, though, its first-in the-class "knowledge-based society" target for 2010 is correct in its essence, but this - with the deadlines vanishing one after another - appears as growingly unrealistic. The project is defined in a collection of buzzwords that can be found in most EU documents of the last 15 years.

3. the first two problems have been partly at the origin of an institutional intimidation of the Commission in its relation with the other EU institutions. The Commission has generally had a low profile over at least the last two mandates. But the main contributor in this is the unprecedented activation of the cleavage between the left and the right and, in general, between the main political groups in the European Parliament. This was strikingly manifest during the appointment procedure for the Commission, but the same type of cleavage is more visible than ever at a wider European scale. The confrontation between the free market (read "Anglo-Saxon") approach and the social protection (French and German) vision is an illustrative oversimplification. While the partisan debate of public interest matters is essential for democracy, its current primitive forms are damaging for Europe's achievements during half a century (by questioning without real arguments the principles of important parts of the *acquis*), and not consolidating democracy. This has negatively influenced the relations between the main political groups within the

European Parliament, which were previously and for a long time based on the idea of compromise. Moreover, a consequence of the EP's in-house fighting is now a rather (unprecedented) hostile relationship between the former allies - the Parliament and the Council.

This explains why, after having successfully administered one of the Union's greatest challenges - the enlargement - the Commission is in a difficult position to administer the enlarged Europe's policies. In order to be able to do that, it needs a long-term policy at all levels, the stability of its relations with the other political institutions of the Union, and, in particular, the genuine trust and support of national governments and public opinions. Moreover, it must be able to feed the decision-making machine with proposals, while the diversification of the working methods is not helping to that. Its current deregulatory approach, said to respect also the subsidiarity principle, appears to be more an episode of weakness than a strategic step.

The European Parliament

It had no major difficulty in integrating the newcomers, although the mutual adaptation might not be easy. However, the leading political position has been divided in a fair way between MEPs from old and new member states. Certainly, this is not the only important issue, and probably counts even more the effective contribution that the overall group of the newcomers is able to bring in the formation of political decisions. Two remarks can be made in this respect:

- a) while in the Commission the integration of new members and staff must fortuitously be quicker, the

Parliament needs well more time until the new MEPs will bring a political contribution that is proportional to their number in the assembly. They are now in a listening mood, but this is natural for the beginning and much welcome.

- b) the effective implications of the 2004 EP elections for the Parliament's political composition and for the ideologies expressed in this agora are, on the other hand, quite significant:
- a slight reduction (- 1%) in the number of EPP members;
 - another small one (- 1%) for the PES group;
 - almost without new members from CEECs, the Greens diminish by 2%;
 - the former ELDR group has grown with the enlargement from 8 to 12%;
 - the euro sceptics from the ID group have doubled, while the UEN group remains unchanged.

The newcomers have a significant weight, exceeding 20%, in the groups of communists, liberals, Christian-democrats, nationalists and euro sceptics. From these groups, with the exception of liberals (now ALDE), who remain partisans of enlargement and relatively favourable to further integration, the other groups are either constantly critical of the European integration process, or have important fractions that are critical. In fact, with the exception of liberals, the only group that has grown following the enlargement and is not entirely euro sceptic is the EPP one, but enlargement brought to him a vocal injection of criticism to Europe with its ODS members (Czech Republic). Thus, EPP's gravity centre is sliding towards the East and

scepticism, while the PES group (in which the weight of new entrants was smaller) remains politically unaffected. While the two major political groups (Christian-democrats and socialists) have redeemed the old "steel pact" uniting them in the EP between 1979 and 1999, their collaboration is difficult. The voting patterns during the appointment of the Barroso Commission and, in particular, the approval of its multiannual program (where PES voted against) illustrate this tension and shows also that the role of liberals and euro sceptic groups will increase and might become even pivotal in future test-cases.

The Council

This is the EU institution, which illustrates best that the strains of enlargement combine with the hardship of consolidating the European construction. If the Constitutional Treaty is indeed dead, as most realists and some political leaders note, following the two unsuccessful referenda in France and The Netherlands, then the Council's working system, with its central element which is the voting system will be the one defined by the Treaty of Nice and the accession treaties of the 10+2 new and future member states (Nice +). The analyses are already abundant as to the serious limits of the Nice voting system, which does not contribute to reducing the Unions' democratic deficit (a formula invented to indicate the problems of the growing number of players in the Council, following successive enlargements, and of the growing number of areas where decisions are made by qualified majority).

The Nice + formula is not answering the democratic deficit problem because, in comparable terms, it offers less votes to the large member states than it offers to the small

ones, while the solution of the Constitutional Treaty was to make the voting power an exact illustration of each member's population.

The Nice + formula is not satisfying the need for efficiency either. Baldwin and Widgrén have demonstrated that the system of the three thresholds (number of votes, number of states and population) dramatically reduces the chances to adopt the legislation, by increasing much more the chances for blocking minorities than of the "passing" majorities to succeed. The chances to pass legislation have decreased currently from 7.8% (EU-15) to 2.1% (EU-27; Nice +). To compare, if the Constitutional Treaty would be in force, the chances to pass legislation could increase radically from 2.1% to 21.9%. It is true that the use of the vote is still not frequent (but more frequent than 20 years ago; about 25% of the legislation is subjected to actual voting in the Council), but this happens exactly in cases where the stakes are higher, i.e. where divergences between member states arise. These 25% of the cases are the test cases that can bring the Union up or down politically, and not the other 75%.

All these suggest that the institution genuinely affected by the enlargement is the Council, following the weak management in Nice of the voting rules. This also explains why the legislative process within the Council has currently significantly slowed down as compared to previous periods (it is also true that a learning process for the new members must also take place, and the situation could somehow improve later, when the rouages will become familiar to everyone).

Conclusions

The relatively different pictures of

each of the three main political institutions of the Union are united by a set of common features:

- if today the political relations between the institutions are quite shaky, this is mostly due to the deepening of European integration (or its refusal).
- however, the nervousness of certain member states, with some consequences for inter-institutional relation, is generated by enlargement.
- moreover, if the decision-making machinery runs the risk of a stalemate, this is because of the enlargement, and in particular of the Council as a decision-making institution.

But it would be wrong to draw the conclusion that the EU's enlargement is the most important source for Europe's today strains (true or imagined). Fixing the decision making mechanism will ease some tensions, but will not heal all illnesses. Possibly the most important lessons of the 2005 referenda is that Europe, instead of running into the future in order to hide from the difficulties of the present, should stop for a while and try to solve its major current problems that are symbolic in the citizens' eyes: economic growth and stability, employment international competitiveness, the solidity of the euro, the completeness of the freedom, justice and security area. These are major achievements or objectives of the last 10-15 years that have once boosted the interest and hopes of public opinions and economic actors. They should become and remain rock-solid in order to allow the Union another leap forward, and only this will help solve the marginal difficulties

created by the enlargement, allowing a full integration in the Union of the new members. Finally, before availing the beginning of new enlargements, one

essential lesson should be drawn from the past episode: the true enlargement does not end by the date of accession, but merely begins then in truth.

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Comments on the topic

“COMMUNITY INSTITUTIONS: HOW CAN THEY COPE WITH A UNION OF 27 MEMBERS?”*

Dragoş Negrescu**

Given the timing of this conference, it is impossible to approach the topic without evoking the spectre of the recently failed referenda on the Constitutional Treaty in France and Netherlands. Does this affect the programmed accession of Romania and Bulgaria, hence the number of eventual Member States? Does it make the already enlarged Union non-governable? These are just some of the questions which immediately come to mind.

Impact on Romania's accession. The Romanian government has recently issued a public statement of re-assurance towards its citizens, explaining that the non-ratification of the Constitutional Treaty bears no consequence for the implementation of the Accession Treaty, since the latter had purposely been drafted in two versions (i.e., catering for any outcome of the Constitutional Treaty ratification). Yet, I read that at least one MEP (Mrs. Doris Pack) has called this interpretation “stupid”. I confess having difficulties understanding how is it possible that an interpretation in good faith of the provisions of signed international treaties can be called “stupid”. But then, again I seem to be generally having difficulties more in understanding the European Parliament's *modus operandi* and, more fundamentally, its sheer *raison d'être*.

It may be, however, that what the distinguished MEP meant is that the

rejection of the European Constitution is indicative of a more general change of mood which turns against Romania. I wonder, then, how can one identify so precisely what prompted the “No” votes? This is not exact science and, moreover, we have absolutely no temporal perspective at this point in time.

If we confine ourselves to facts, then:

- a) the Accession Treaty is in no way conditioned by the fate of the Constitutional Treaty;
- b) the Nice Treaty had already made the indispensable institutional adjustments allowing for enlargement;
- c) there is nothing really dramatic in substance that the Constitutional Treaty brings as novelty to begin with.

Which brings me to the next question, namely **“why was the Constitution deemed necessary?”**. Here, again, views expressed are not fully convergent, but most of them refer to the need to palliate to the much-decried “democratic deficit”. Just like “globalization”, this is yet another over-used and under-specified concept. I do not see how sovereign states with democratic systems exercising their prerogatives as subjects of international public law and fulfilling their own national legal procedures for transposing into domestic law the commitments undertaken internationally

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can dent democracy so much as to trigger a shortage of it. And I find that this theory is very similar to those vilifying the WTO as the source of all evils, simply because states have committed under its aegis to do / not do certain things. After all, the very essence of international treaties is to limit the discretion that states can exercise in their conduct. This has served human kind well for millennia. What is so special about the new one?

Hence, I do not see the “democratic deficit” as a problem. That is, only as long as we keep European integration in the realm of inter-governmentalism. Once, however, this concept is assigned more “unionist” (“federalist”) features, things change. Yet, in such a case, it is the appropriateness of the “federal” path which should have been debated and, eventually, dealt with by the Convention.

Besides, even assuming that the “democratic deficit” indeed is a problem, I do not see how this was supposed to be solved by the Constitutional Treaty. The increased powers of the European Parliament are not dramatic. Even more importantly, they cannot not be the answer:

a) because the European Parliament is (and seems to remain for a long while from now on) a minor league as compared to the national political arena, hence it tends to be the locus of second-rank politicians (top ones playing in national competitions, where there is a prize to win: power)

b) because there is nothing to back the assumption that MEPs are particularly representative of their people, in a manner that governments (who “play” in the Council) are not. European elections are most often used by the electorate as a means

to pass signals to the national politicians in relation with domestic issues. Also, the recent debates during the referendum campaigns (especially in France) have shown numerous episodes of MEPs holding views completely at odds with the prevalent perceptions of their constituencies¹.

At the end of the day, it seems that the only tangible step towards tackling the “democratic deficit” consisted in the super-elaborate mimicking of a bottom-up approach by the Convention, which purported to give a say to the grass-roots by using a “top-down hand-picking” system for identifying their spokespersons. Yet, the EU Constitution is more “esoteric” than any national constitution (being both more technical and more philosophical) and this makes it even less amenable to genuine public debate. This should have been taken as a sunk cost. Instead, a convoluted play was staged, in an attempt to leave the impression of genuine grass rootism. In fact, the EU Constitution is, categorically and unmistakably, still the construction of an elite. I see no problem with this and I even think it is unavoidable. But, I certainly see no need for dressing it up as “democracy in action”.

When it came to approving the outcome of this exercise by referenda, many people voted “against” for lots of different (and even opposed) reasons: lack of reference to Christian roots; enlargement, i.e. lack of reference to EU borders rather than fear of Romania/ Bulgaria in particular; too liberal approach; instrument bearing the “anathema” of globalization; imposition from above by an elite; protest against own government; no proper campaign for yes.² Summing up, we have:

¹ Most visible case in point: Daniel Cohn-Bendit, vocal and acerbic supporter of the “Yes”, although his CV is perfectly compatible with the groups who have massively voted “No” (greens, leftists).

² As the Belgian Minister of Foreign Affairs has so delicately diagnosed the case of neighbouring Holland's referendum.

- on the one hand, divergent views as to what EU's physiognomy should be, which arise from identifiable interests;

- on the other hand, differences which are completely unexplainable, and yet are very strong.

All this leads me to believe that the time has not come yet for this project. The counter-argument, namely the perpetual need (identified by Jacques Delors) for a grand chantier, is not persuasive. At the end of the day this is just another version of the "bicycle theory" so familiar to trade policy scholars. This concept presupposes that, left to themselves, people will naturally lean into the opposite direction (i.e., dis-integration), hence the need to constantly keep them busy. But, if this is the case, we do not really have a constituency for an "ever closer union" and trying to extract one would be the direct contradiction of democratic principles.

As already hinted, I do not think the Constitutional Treaty makes any big inroads into simplifying the decision-making mechanism within the EU, although this is widely regarded as the most vulnerable point after enlargement. It is, of course, easier all other things being equal to take decisions among few than among many. But, then, based on this criterion, there should not have been any integration at all. The reason for which integration exists and becomes more and more prevalent is that it brings economic benefits and, according to Richard Baldwin's domino theory of regionalism, these benefits are increasing with the size of the grouping.

There are other ways, apart from reforming the institutional setting of the EU, for lessening the burden of decision-making:

opting for regulatory competition over regulatory harmonization. This would bring to the fore the issue of values: many (perhaps even a majority in some countries) will say that unfettered competition means destroying the environment, exploiting labor, alienating the human race etc. Hence, the need for minimum standards.³

Does one really need commonality of values in order to engage in international transactions? This has seldom been an issue as long as international transactions concerned mainly goods and it surfaced as a priority only recently and in ways which do not preclude the existence of protectionist intents. Furthermore, seldom anybody cares for commonality of values as far as capital movements are concerned or as far as the so-called "modes" I (cross-border supply), II (consumption abroad) or III (commercial presence in the territory of another country) of international trade in services are concerned. This becomes a big issue only when we talk "services mode IV" (presence of natural persons the "Polish plumber in France" syndrome) and free movement of persons. Coincidentally or not, these happen to be precisely those areas where poorer countries stand to gain more, at least from a static perspective. Is this sheer coincidence?⁴

Coming back to the issue of decision-making among many members: there are no big complications if one takes the "competitive" venue. But the competitive venue seems to be the less palatable to the "standard setters" the more "poor" members you have. Hence, the problems created by enlargement to decision-making are not so much numerical (number of members), but linked to the widely diverging prosperity

³ It is ironical that, in these areas, the most vocal "Europeanists" are advocating uniformization, yet they are staunch defenders of diversity in other respects: religion, culture ("shun Hollywood"), sexual orientation etc.

⁴ If we go into the dynamic scenario, we may start worrying about "brain drain" and the like.

levels between “old” and “new” Member States. But, then, if newcomers are expected to abide by strict standards, why not to devise a decent trade off whereby, in exchange for adhering to these more demanding standards, the amount of redistribution available to them (structural and cohesion funds) increases? Instead, the redistribution aspect is played down and the

standards aspect is played up. In other words, one overburdens the decision-making mechanism while holding back the oil that would make it run smoother. This is a contradiction whose resolution would do much more good to facilitating the operation of a EU with 27 Member States than the entry into force of the Constitutional Treaty.

THE CONSTITUTION IS DEAD. LONG LIVES THE TREATY OF NICE?*

David Král**

Introduction

June 2005 is perhaps going to be described in history books as a black date in the process of European integration. Just over one year after people across the continent celebrated the biggest ever enlargement of the EU and the reunification of Europe, all the enthusiasm suddenly seems to be gone. The outcome of the French referendum on the Constitutional Treaty on 29 May 2005 came as a first blow to the new phase in European integration which was underway since the inception of the work of the Convention in February 2002. But this time, the result was nothing close to the outcome of the French referendum on Maastricht. While in the former case, the result was basically a draw (with roughly 51% in favour and 49% against), the vote on the Constitutional Treaty was a clear victory of the "no" camp, having mobilised 55% of those who turned up to cast their ballots against the document. The results of the Dutch referendum were even more astonishing 62% of Dutch voters opposing the new treaty and mere 38% in favour is by far the worst outcome of any EU-related referendum in any country, and it came from a founding member which had

been always considered to be one of the driving forces behind the project.

This article will not look into the reasons why the French and the Dutch voters decided to vote against the Constitutional Treaty. It will rather look into examining the feasibility of different scenarios how to proceed further with the Treaty whose fate is at doubts now. It will also try to assess the likely consequences of the current constitutional crisis in the EU, which in a certain way links back to the reasons for the refusal of the Treaty. The main argument of this article is that it would be politically impossible as well as illegitimate to try to save the Treaty in its entirety, as well as to try to "salvage" certain elements of it by introducing them by the backdoor tactics, although it might seem uncontroversial and necessary. What is needed most of all is a new quality of European leadership, which will be able to face the challenges posed by the recent developments in the EU and find an effective response to them. If the Treaty is not adopted, the EU leaders in order to restore the trust of citizens in the European project, have to show that the EU is able to deliver even under the current framework, in areas

* Prepared from remarks at the 5th Anniversary Conference of the European Institute of Romania: "NEW AND FUTURE MEMBER STATES. HOW TO ACT IN EU-27?", held in Bucharest, 8th - 10th June, 2005, the present paper is an assessment of different scenarios how to proceed with the failed ratification and possible consequences for the future of the EU.

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such as foreign policy or anti-terrorism. This might require a large degree of trust among the member states but perhaps a far greater degree of internal differentiation in the EU than we see nowadays.

Imminent questions after the failed referenda - to go on or not to go on?

The failure to ratify the Constitutional Treaty in two countries of the EU posed an immediate question how to tackle the issue in those countries who have not yet ratified. At the moment of the Dutch no vote, ten countries out of 25 have already completed the ratification process, with one country (Spain) having already held a non-binding referendum in February 2005. Luxemburg furthermore joined this list in July 2005 after a positive outcome of a referendum, making the overall number of ratifying states eleven.

But quite clearly, according to the amendment procedure included in the current treaties as well as in the Constitutional Treaty, the new treaty cannot come into force but by unanimous ratification in all the member states according to their own constitutional provisions. Thus those who argued that the ratification should not go on claiming that it would be impossible to adopt the new text if it was already refused in two countries. One of the first leaders to bury the treaty soon after the French and Dutch votes was the Czech President Klaus, a well-known opponent of the document and actually the only head of state in EU-25 being outrightly opposed to its adoption. Most of the other EU leaders, however, were far more cautious so as not to bury the treaty immediately. The prime ministers of some countries that were supposed to hold the referenda and had already announced the dates issued statements that the referenda would be postponed, namely United

Kingdom, Ireland, Denmark and Poland. That was the least that could be done to calm down the stormy waters of the European public opinion. Almost immediately after the results of the French and the Dutch votes came out, the opinion polls across Europe started to show a considerable drop in support for the Constitutional treaty, a phenomenon which is evident notably from the latest Euro barometer 63 poll published in July 2005. The crucial decision had to be taken by the EU leaders at the June 2005 summit, to which the issue of continuing ratification obviously remained one of the crucial points.

To stop the ratification process would equally require a unanimous agreement of the EU-25 leaders. Unilateral suspension of ratification could be interpreted as acting against the purpose of the new treaty, required from the signatories under general international law and the Vienna Convention on Treaty Law. But to reach the consensus on the termination of ratification at this stage would probably be problematic because of several reasons. The first is the position of the countries that have already ratified. One of the first comments of the Spanish PM J. L. Zapatero was that the ratification should proceed, because the Spanish "yes" vote does not weigh less than the French "no" vote. Very similar voices could be heard from the other capitals that ratified. Their fear was largely motivated by the fact that this rather comfortably accomplished ratification through Parliament could suddenly become complicated if there are substantive changes or if the issue is brought back to the table again. It was also pointed out by the proponents that, despite the negative votes in both France and the Netherlands, majority of the people who had a say actually voted yes (including the Spanish

vote), and so did a majority of countries. One of the main proponents of the continuation of the ratification was President Chirac. The failure to secure a “yes” vote now creates a pressure on the French and Dutch governments, who can be now blamed for any hindrance in the progress in European integration, and considerably decreases their bargaining position at the European playground. If France and the Netherlands remained the only recalcitrant countries (which might not be the case if the ratification continues), their influence in the EU would probably be diminished for a long period of time.

But the main argument for the proponents of continuing ratification was Declaration n. 30, attached to the Constitutional Treaty, stipulating that if by October 2006, problems with ratification endure in one fifth of the member states, the matter will be referred to the European Council. This implies that all the member states are supposed to have a try in ratification, and only after the end of this period, possible problems would be tackled. However, neither in the Treaty nor in another form was it made clear in what way the European Council could deal with the issue nor possible scenarios remained at the level of speculation.

The European Council meeting in June 2005 failed to give efficient responses to the constitutional crisis in the EU. The crucial decision not to halt the ratification at this stage was taken, but a clear way to get out of the crisis was not communicated. Instead, the EU leaders decided somewhat misleadingly to head for a “reflection period”, but the length and contents of this initiative remain obscure. It was not suggested whether the reflection period would be managed in a synergic way at both

EU (Commission, Parliament, Council initiatives) and national or even lower levels. The key commitment of the re-run of the referenda in France and the Netherlands was not made either, and under current political climate could not have even been expected. Thus, the key outcome of the meeting was that the leaders postponed the uncomfortable decision for a later time. This demonstrates a clear lack of leadership and vision in the EU to tackle the imminent problems with enough innovation and courage.

Possible scenarios of dealing with the constitutional crisis

It does not take much imagination to think about possible ways to tackle the current impasse. Let us explore them one by one, suggesting possible opportunities and pitfalls for their viability.

Continuing ratification

The first possibility is to continue with the ratification as if nothing had happened. In fact this is what the EU leaders suggest to do, only having acknowledged that the original deadline of November 2006 for the entry into force will not be met. The main pitfall of the scenario is that it is absolutely unsure what the outcome is going to be. It might help us to identify how deep the crisis is, if there are more countries that refuse the treaty, and this is quite likely, at least in case of the UK but perhaps others (Poland, Denmark, Czech Republic). But even if the referenda pass in all the other countries that are about to hold them, without the French and the Dutch yes the treaty cannot come into force. Thus, this scenario would have to count on the fact that the votes in the two countries will be repeated. This can realistically happen in France only after the presidential election in

2007. In the Netherlands perhaps before, but it is not very likely, as the Dutch government will probably try to use the positive spin-off if the French are more likely to vote yes with the new leadership. This will be, in many ways, the most optimistic scenario for many in Europe in terms of its effect, because it will save the Treaty in its entirety, and preserve a fragile and well-struck compromise without having to think about alternatives. But it will leave Europe seriously wounded in terms of public opinion terminating the period of permissive consensus on European integration. The period of uncertainty, while Europe is waiting for the French and the Dutch to vote again, would apart from paralysing the political and decision-making processes - send a very negative signal to the European public, suggesting that EU referenda are intelligence tests with only one correct answer. The public discontent with the EU would deepen, leading to even more Euro scepticism and cleavage between the citizens and political elites. Moreover, the likelihood that the votes will be repeated, especially in France, is very low according to many experts.

Renegotiation of the treaty

The next option that comes to the fore is a renegotiation of the text (either full or partial) and adoption of a new one, or amendments to the existing one. This scenario is even more unrealistic. Everyone who has followed the process of the Convention and through IGC knows that the final document presents a very fine and fragile compromise, and starting the negotiation exercise from scratch would be almost impossible at least at this stage. Renegotiation of parts of the text would not provide an immediate solution either.

Firstly, unlike in the Danish case on Maastricht in 1992 or in the Irish case on Nice in 2001, the reasons for the refusal of the treaty in France and in the Netherlands are much less clearly identifiable. Therefore, adopting some amendments that could comfort the French or the Dutch voters, or just attaching to the text a declaration like in the case of Ireland on Nice does not seem to be an option. Moreover, what might respond to the concerns of citizens in one country (e.g. more emphasis on "Social Europe" in France) will almost certainly increase opposition to the text in other states in this case for instance the UK or the Netherlands. Secondly, one must not view the Constitutional treaty as a sum of different provisions but very much as a package deal. Thus opening up certain provisions would equal opening of a Pandora box, because the agreement of some governments with certain arrangements was seen as a trade off with others.

Dividing the treaty into two documents ("Constitutional Treaty Light")

Another option that was floated around recently is the idea of splitting the actual text of the Constitution into two parts. This notion was officially articulated by the cabinet of Polish president Kwasniewski but was also taken up by some MEPs and it was in fact discussed already during the Convention. The arguments behind this relate mainly to the fact that it was not the constitutional part of the new treaty (i.e. Part I and Part II) but the policies part (Part III) for which the citizens in France and in the Netherlands refused the document. As especially Part I is seen as crucial for the efficient functioning of the EU-25+, the idea is that by adopting only the first two parts (including Charter of Fundamental Rights

Part II), a large and in fact most important part of the Constitutional Treaty will be saved while for the more controversial provisions, status quo will be preserved. Moreover, this would respond to the concerns often articulated in various debates that the current Constitutional Treaty is too long, illegible and ordinary citizens will not be able to understand it. The new, truly constitutional text would meet these expectations. Alluring, as this may seem compared to the previously envisaged scenarios, it still poses considerable shortcomings. Firstly, the ratification process would have to be stopped and a new treaty adopted, which still leaves us with the problem of those countries that already ratified. But secondly, and perhaps more importantly, following this scenario would mean that the EU would actually fail in one of the main goals highlighted in the Laeken declaration, i.e. in consolidation of the existing primary law and simplification of the whole legal and institutional framework. One can probably hardly imagine the mess emerging from adopting a new “constitutional” treaty alongside the existing treaties (Treaty establishing EC and EU). Amendments to the current treaties would certainly be needed in any case, albeit they might seem only technical in nature, because Part I creates to large extent a new framework and new terminology. Conversely, Part I bears many references to Part III that would have to be omitted. But sometimes the Constitutional Treaty completely turns around the logic of the EU functioning. For instance while current treaties stipulate that unanimity is the basic rule for decision making in the Council and the application of QMV has to be explicitly acknowledged, the Constitutional Treaty builds on a completely reversed premise QMV is the rule as long as the treaty

stipulates that unanimity applies. It goes similarly for the legislative procedures and involvement of the Council and the European Parliament. Thus the idea that it would be possible just to “cut out” Part I and II and adopt it alongside the current treaties is grossly naive. Furthermore, the EU leaders would hardly escape the temptation to introduce changes in the EU policies once the issue is open, because the Constitutional Treaty did make some important improvements there, namely in Common Foreign and Security Policy (CFSP), European Security and Defence Policy (ESDP) and in the area of Freedom, Security and Justice.

Informal introduction of some elements (Nice Plus)

Another scenario, which gets close to the one previously described, would reckon on the informal introduction of some elements envisaged in the Constitutional Treaty. The idea is that certain provisions could be adopted under the current framework without having to amend the applicable treaties. The argument in favour of this solution could be that certain practice already works this way in the current EU for instance, the so-called financial perspectives are basically an inter-institutional agreement between the Council, European Parliament and the Commission. Also the European Defence Agency was established without a clear treaty mandate. However, it is doubtful which elements could be introduced in this “cherry-picking” manner. The ones that are most often referred to are for instance EU foreign minister, External Action Service, team presidency, deliberation of the Council in public while legislating or the early warning mechanism for national

parliaments. While this scenario also seems quite feasible, it is doubtful whether it can actually propose answers to the most imminent questions. The new mechanism of QMV as well as its extension to other policy areas was often described as indispensable for an efficient functioning of the EU, but they would certainly need treaty amendments. Moreover, trying to introduce some provisions informally might give the impression that the EU leaders are trying to introduce certain elements of the Constitutional Treaty by the “backdoor” tactics. Also what was described as a package deal would be unravelled again, thus the obstacles relating to the adoption of the provisions mentioned would almost certainly bring along new round of negotiations, likely to happen in a very non-transparent way. This could provoke a negative backlash from the European public opinion, leading to even greater alienation of the citizens from the elites. Therefore, if this option were to be viable, a coherent strategy of how to communicate these changes to the European citizens would have to be developed.

Everything stays as it is (Nice scenario)

The last scenario envisages that none of the above-described options could be agreed upon, and the European Union would have to continue under the framework set by the Treaty of Nice. While on one hand this option seems rather uncontroversial, it can hardly provide a long-term solution. It would almost certainly lead countries that want more integration in certain areas to co-operate outside the treaty framework, especially if they find the current provisions on the enhanced co-operation too stringent. But much depends

also on how workable the EU is going to be under Nice. It has not been in force long enough to make accurate judgements, but it seems that even after the enlargement, the catastrophic scenarios that all the decision making would collapse did not prove right. If the EU leaders and member states are unable to agree on any better framework by adopting a new treaty, the European Union is likely to experience a far greater degree of internal differentiation than we see nowadays, and indeed even scenarios about EU completely re-founded can become a reality. The impact of these developments are very difficult to assess, however, they are likely to be detrimental for the EU, as we know it today.

Lessons from the crisis?

From what has been said, it seems that there is actually no obvious way out of the current crisis without serious obstacles or pitfalls. Still, it does not mean that the effect has to be disastrous for the EU. But it has to be taken seriously by the political elites in the member states. Any attempts to play the situation down would not help finding an efficient response to it.

As for the lessons that are to be drawn from the current crisis, what seems to be clear is that that the period of permissive consensus, which Europe experienced throughout the whole post WWII history, is probably gone. European integration is no longer a matter of elites, who can drive the project forward, occasionally asking the citizens to legitimise their decisions, either ex ante or ex post. Paradoxically, it was the Constitutional Treaty, which was supposed to create a far better framework for involvement of citizens in EU politics and make Europe more comprehensible to

them. And it was the citizens who turned this initiative down. The simple conclusion would be that the European leaders failed to communicate the benefits of the treaty well to the electorate. This could be partially true. In Lithuania or Hungary the adoption of the treaty passed virtually unnoticed, without any public debate. In Spain relatively few people bothered to vote, and most of those who turned up did not know what the treaty was about anyway. On the contrary, in France where the people voted against, a very profound debate touching virtually all the levels of society took place. Thus the simple lack of communication cannot explain the public opposition.

Part of the explanation might be the fact that citizens are simply not able to distinguish between “European” and “national” issues. In France it was the French government who was “selling” the Treaty, not the Commission or the European Parliament. Obviously, it is difficult to cast ballot for something proposed by the government that one despises. This nationalisation of the debate was very much fostered by the fact that not many “European” stakeholders appeared in it. This kind of public involvement is highly unlikely to add to the legitimacy of European project.

Still, even the French case cannot provide a definite answer to the motives for the lack of public consensus. In the Netherlands, the debate was much less “nationalised” and in many ways it was about Europe and about the place of the Netherlands in it. One of the explanations is that the Constitutional Treaty actually does not address the issues that the Dutch would like to see debated where Europe is heading and where it is going to stop.

These conclusions pose serious

challenges to the European leadership, as they put qualitatively new questions, which have not been tested, and it is very difficult to find parallel situations in the past. It is nonetheless clear that if there is to be a treaty-based integration, it has to go beyond rather narrow-minded thinking of national boundaries, policies and interests. For instance, the idea that the new treaty could be approved in a Europe-wide referendum was turned down as something “unacceptable” in terms of national sovereignty. While this can be understood, because it would twist around the idea of the EU being based on a consensus of member states, what could have been easily implemented was for instance an agreement to harmonise the dates of referenda on the EU constitution. A parallel can be found with the EP elections while the framework is completely set by the member states, the dates are harmonised through their agreement. This would provide for a better interconnection of the individual country debates and their “Europeanisation” (as opposed to “nationalisation” in the French case). Apart from that, it would avert the current paralysis where the political decision-making is largely stuck because of an enduring constitutional impasse. Nobody dares to assess how many more countries can vote against, and whether the French or Dutch will get a second chance. The failure to agree on this simple measure just shows how much the EU leaders think in their narrow national frameworks. In this respect, the current crisis might be a useful wake up call but it might also come too late.

Similarly, the Dutch example shows that the Constitutional Treaty actually failed to address the issues that are really of citizens’ concern i.e. the questions of what the EU should and should not do and how much Europe we need in different policy

areas. Too much time in the Convention and IGC was wasted talking about institutional arrangements which would improve efficiency, without actually addressing what and why this and that should be done more efficiently. The EU policies were debated during two single sessions of the Convention, yet transposed into by far the most extensive part of the Constitutional Treaty. It is obvious that the EU would have, sooner or later, to get down to discussing these issues that were left aside. There is no guarantee that a wide-ranging consensus would be reached when it comes to issues such as the degree of (financial) solidarity in Europe, either among countries or among citizens. But it should have already happened during the Convention. If Europe is going to proceed this way, it would certainly need another forum of this kind in the (perhaps near) future, which would, however, interlink much better with the civil society.

Consequences

The consequences of the current crisis depend on many variables; including how long the crisis is going to last and what is going to be the outcome. But some estimates can be done as to the short-term prospects for the developments at the European stage.

Firstly, and perhaps most obviously, the appetite for any further enlargement is going to diminish considerably. And this is not only because in France and the Netherlands the “no” votes were often interpreted as the votes against enlargement, including the previous one in May 2004. The European Union is faced with unprecedented situation when it failed to enlarge and reform simultaneously. The

Constitutional Treaty was seen as a way of creating a more efficient and workable framework for EU-25+, and the prevailing political consensus is that the status quo provided for by the Nice Treaty is not satisfactory in the long run. The likely victims of the “enlargement fatigue” are not countries who have already signed the accession treaties, i.e. Bulgaria and Romania, albeit their membership might be postponed. It relates mostly to the other countries clearly on the track of EU membership, namely Turkey and Croatia. The launch of the accession negotiations with Turkey will be the first litmus test of the sincerity of the EU to take further enlargements seriously, despite some specifics surrounding the Turkish case.

Apart from enlargement, the progress in the other areas of the EU external action can prove problematic, too. The Constitutional Treaty was expected to improve considerably the viability of EU foreign policy, not least of its defence branch, and it made some major improvements in this respect, including the EU foreign minister, EU External Action Service, modest extension of QMV on foreign policy issues or easier conditions for enhanced co-operation. Thus the desire of many European citizens to see a more coherent EU foreign policy might face many obstacles arising from the deficiencies of the current framework. There is still a chance that despite the failure to adopt the Treaty, certain measures can be implemented, with all the risks and pitfalls described previously. But the EU aspirations to be a global actor might prove too ambitious and the desire to put the EU on equal footing with the United States only wishful thinking. Perhaps the EU needs to realize that before it wants to engage on a global scene, it has to prove that it is capable of engaging and

delivering in areas in which the member states can agree, such as those of primary interest for the EU the Eastern and Southern neighbours and the Middle East. This would require a large degree of consensus building, but if the EU succeeds, it might help substantially to restore its credibility among the citizens as well as among those countries directly concerned.

Internally, the failure to adopt the constitution poses uncertainty about the homogeneity of the EU integration. It is doubtful whether under the current framework the EU can integrate further on the treaty basis, because the negotiation in the EU 25+ format turns out to be increasingly difficult, and so does the subsequent ratification in all the member states. Perhaps the EU will need to find a far greater degree of flexibility. It might be implemented in the existing treaty framework, e.g. by means of introducing enhanced co-operation among certain countries. But in case the current rules are found too stringent, the countries might decide to proceed outside the treaty framework and start co-operating outside the EU, like they did for instance in case of Schengen, hoping that they will serve as "avant-garde", with the rest following suit at a later stage. Greater flexibility should ultimately be accepted as part of the complicated reality of the future EU development and not something that necessarily has to be detrimental. Adversely, if more heterogeneity in the EU is accepted by the member states, the appetite for further enlargement can paradoxically increase again, because it will not be viewed as something imperilling the very substance of the European project.

The failure to secure the adoption of a hard-struck compromise on the Constitutional Treaty would also likely

result in a general paralysis of decision-making in the EU, not on a technical, day-to-day basis but in terms of the likelihood to agree on big goals and projects. These require a large consensus of the member states which will be much more difficult to conceive. Already at the moment we can see a large degree of mutual distrust and different cleavages between big and small, older and newer, richer and poorer or more social and more liberal member states. The member states are going to be much more trapped by their domestic debates, where the controversy of some proposals such as the liberalisation of services or the financial perspectives is going to feature much more than until now. This in itself is not bad for a greater democratisation and legitimacy of the EU project but it will make the substantial progress at the EU-level much harder to achieve, which paradoxically again can lead to the failure of the EU to deliver tangible benefits and prevent the restoration of trust of EU citizens in it. Countries such as France will be much more cautious in agreeing to any project that could further intimidate the domestic electorate, such as the reform of Common Agricultural Policy or anything that might imperil the cherished European social model. Thus the "big projects" for Europe to engage in seem to be in the area of EU external policy rather than in the internal ones for instance anti-terrorism policy or foreign policy in general which are likely to be accepted less controversially by the citizens. But these areas require much more of the will of member states to work together as well as a large degree of mutual trust in terms of sharing sensitive information, due to the fact that they are still largely based on inter-governmental principles. To what extent this could happen under current circumstances is still doubtful.

Finally, the greatest short-term challenge for the European leaders in the upcoming future linking to all the points mentioned previously will be to restore the trust of citizens in the EU and try to bridge the enormous gap between the political elites and the Europeans. It is very difficult to give any guidance at this stage. However, it seems clear that this time the initiatives cannot remain at a proclamative level but should bring forth some concrete proposals. These might for instance provide for measures that would include engaging the national parliaments in the debate on controversial pieces of EU legislation, such as the service directive or anti-terrorism measures. The bodies such as the Forum on the future of Europe during the Convention, organised on a national basis, should become a regular platform for discussing various initiatives taken at the EU level. It could engage not only national bodies, but also for instance the Commission officials or members of the European Parliament. Undoubtedly, many other ways in which the national, regional and local levels would interact with the EU institutions can be envisaged.

ECONOMIC ASSESSMENT OF SOUTHEAST EUROPE: CATCHING-UP CONTINUES, BUT ACCESSION PROSPECTS UNCERTAIN¹

Gábor Hunya*

Introduction

Southeastern Europe has only a modest deceleration of economic growth in 2005. Thus its catching-up process continues. A deterioration of the already high current account deficit is a major concern. Monetary policy is usually insufficient to deal with the problem and the exchange rate regimes are set mainly to combat inflation. Fiscal tightening is the usual policy response even if the budget deficit is low.

EU enlargement is now more uncertain than a few months ago. The likelihood increased that Bulgaria's and Romania's 2007 accession will be delayed by one year and that negotiations with Croatia and Turkey will not start this year. But until now there is no new policy decision on the part of the EU, while the accession and candidate countries are increasing efforts to meet requirements thus keeping to the agreed schedule.

The region under discussion in this paper includes the two EU accession countries Bulgaria and Romania, two candidate countries, Croatia and Turkey and the other countries of the Western Balkans, all-aspiring for EU membership. We shall refer to nine countries, treating Serbia and Montenegro separately because in economic terms they are already two

countries, they form neither a customs nor a currency union and have separate fiscal policies; in addition, their statistics are separated. Also due to statistical reasons, our analysis excludes Kosovo. Turkey is for the first time integrated into the Southeast European region with which it shares common aspirations to become EU member. The statistical information on SEECs is generally much narrower and less reliable than for the NMS with the partial exception of Bulgaria, Croatia, Romania and Turkey.

Catching-up continues

The Southeast European countries (SEECs) are definitely less developed than the new EU members in terms of GDP per capita in PPP. According to the most recent calculation, in 2004 Romania was at 32% of the EU-25 average, Bulgaria at 30%, while Croatia with 46% was similar to the largest new member state, Poland. Over the last four years, these SEECs have reduced their distance to the EU-25 average, Bulgaria by three percentage points, Romania by seven and Croatia by five (Annex Table A/1). Turkey is just behind Bulgaria with 29% of the EU average but it has hardly surpassed the pre-crisis year 2000 level. The rest of the Western Balkan countries are even less developed, at 25-27% of the EU-25 average, with Albania closing the row with only 20%.

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Among them Albania has been catching up most rapidly while Macedonia fell back.

Incomplete statistics for the first quarter of 2005 suggest that a solid rate of about five per cent economic growth is now present throughout the region with the exception of Croatia which grows only at below 3% (Table 1 and Fig. 1). Croatia grows even less than the NMS which points to structural weaknesses especially in the manufacturing sector. The larger of the accession countries, Romania had extraordinarily rapid growth in 2004 (8.3%)

rapid structural change and improved export competitiveness. In the course of preparing for EU membership they stepped up reforms and improved the conditions of doing business. Economic growth in Serbia and Turkey, similarly to Romania, will fall out lower than in the previous year. Montenegro and Macedonia, which were lagging behind in the past, will probably benefit from accelerated growth in 2005.

Some of the countries in the region are still below their pre-transformation GDP. Only Albania, Romania and Croatia have

Table 1
Gross domestic product
real change in % against preceding year

| | | | | | | | | | | | | Index 1990=100 | Index 2000=100 |
|----------------------|------|------|------|------|------|----|----------------|------|----------|------|-------|-------------------|-------------------|
| | 2000 | 2001 | 2002 | 2003 | 2004 | 1) | 2004 | 2005 | 2005 | 2006 | 2004 | 2004 | |
| | | | | | | | 1st quarter | | forecast | | | | |
| Albania | 7.3 | 7.6 | 4.7 | 6.0 | 5.9 | | . | . | 6.5 | 6.5 | 143.9 | 126.5 | |
| Bosnia & Herzegovina | 5.5 | 4.5 | 5.5 | 3.0 | 5.0 | | . | . | 5 | 6 | . | 119.2 | |
| Bulgaria | 5.4 | 4.1 | 4.9 | 4.5 | 5.6 | | 4.5 | 6.0 | 5.5 | 5.3 | 97.7 | 120.6 | |
| Croatia | 2.9 | 4.4 | 5.2 | 4.3 | 3.8 | | 4.2 | . | 3 | 3 | 101.9 | 118.9 | |
| Macedonia | 4.5 | -4.5 | 0.9 | 2.8 | 2.9 | | 2.4 | . | 4 | 4 | 92.9 | 101.9 | |
| Romania | 2.1 | 5.7 | 5.1 | 5.2 | 8.3 | | 6.2 | 5.9 | 5.5 | 5.5 | 106.5 | 126.6 | |
| Serbia | 4.2 | 4.8 | 3.7 | 2.6 | 7.0 | | . | . | 4 | 5 | . | 119.3 | |
| Montenegro | . | -0.2 | 1.7 | 2.5 | 3.0 | | . | 1.9 | 5 | 5 | . | 107.2 | |
| Turkey | 7.4 | -7.5 | 7.9 | 5.8 | 8.0 | | 11.8 | . | 6 | 6 | 162.1 | 114.1 | |

Note: 1) Preliminary.

Source: WIIW Database incorporating national statistics, forecast: WIIW

spurred by private demand and a bumper harvest which cannot be repeated. Quarterly GDP growth rates are falling in Romania while accelerating in Bulgaria. The expected 5.5% economic growth in 2005, identical in both countries, is the result of

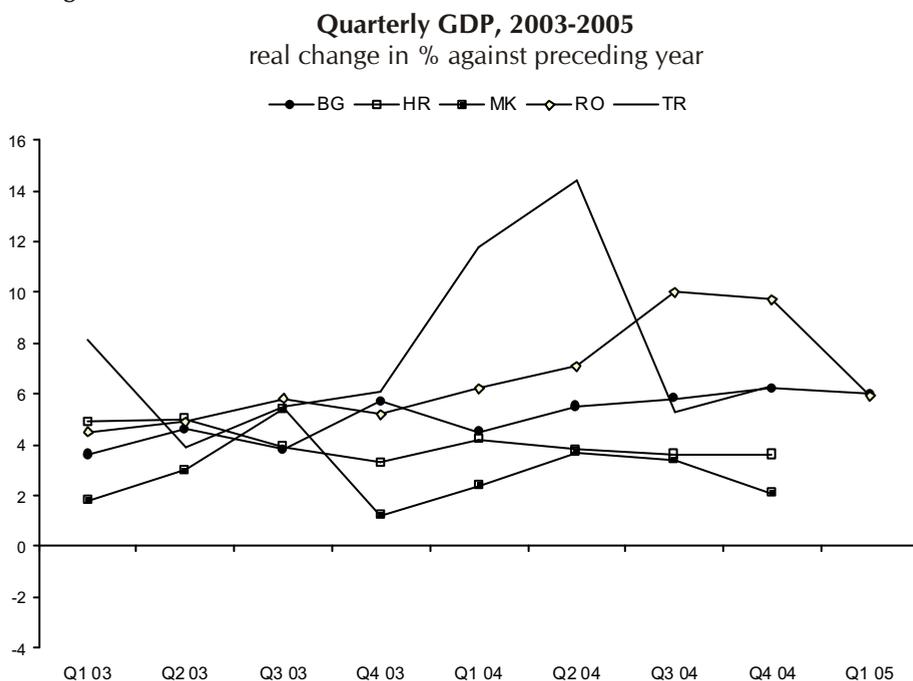
surpassed that level, Bulgaria and Macedonia are close to it. Serbia and Montenegro, also Bosnia and Herzegovina which suffered serious setbacks in the 1990s still have a long way to go, especially since their growth performance has not been

higher than that of the other countries in the region. Institutional reforms and structural changes are still on the way and large amounts of investments would be necessary to modernize infrastructure. Without such reforms, foreign and domestic private investments cannot grow rapidly.

Gross fixed capital formation grew most rapidly in Bulgaria, Romania and Turkey, at double digit pace in 2004, promising fast future economic growth and structural change (Table 2). But in the first quarter of 2005 in all these countries it fell short of the pre-year rate and a deceleration of investment activities is forecast for 2005. In the two accession countries foreign direct

investment reached record amounts in 2004 supporting privatisation and economic growth (Table 10). More modest inflows are forecasted for 2005². Turkey is different, as fixed capital formation has, despite recent fast growth, just reached the pre-crisis level of the year 2000. Continuing rapid expansion of investments is predicted. But this country is still less open to FDI, which may delay the inflow of new technology and know-how. Beside these countries, only Croatia publishes national accounts conforming international standards which show that the construction boom is over and fixed capital formation slowed down in 2004.

Figure 1



Source: wiiw Monthly Database incorporating national statistics.

² See for details: wiiw database on foreign direct investment in Central, East and Southeast Europe 2005. May 2005

Table 2

Gross fixed capital formation
real change in % against preceding year

| | | | | | | | | | | | Index 1990=100 | Index 2000=100 |
|----------------------|------|-------|------|------|--------------------|----------------|------|----------|------|-------|-------------------|-------------------|
| | 2000 | 2001 | 2002 | 2003 | 2004 ¹⁾ | 2004 | 2005 | 2005 | 2006 | 2004 | 2004 | 2004 |
| | | | | | | 1st quarter | | forecast | | | | |
| Bulgaria | 15.4 | 23.3 | 8.5 | 13.9 | 12.0 | 22.1 | 9.2 | 8 | 10 | 144.3 | | 170.7 |
| Croatia | -3.8 | 7.1 | 12.0 | 16.8 | 4.4 | 8.9 | . | 4 | 4 | . | | 146.3 |
| Macedonia | -1.5 | -8.6 | 17.6 | 1.1 | . | . | . | . | . | . | | . |
| Romania | 5.5 | 10.2 | 8.2 | 9.1 | 10.1 | 7.3 | 5.2 | 7 | 8 | 154.6 | | 143.2 |
| Serbia ²⁾ | 13.3 | -4.1 | -0.8 | . | . | . | . | . | . | . | | . |
| Turkey | 16.9 | -31.5 | -1.1 | 10.0 | 35.0 | 57.6 | . | 25 | 15 | 154.4 | | 100.5 |

Notes: 1) Preliminary. - 2) Gross fixed investment.

Source: wiiw Database incorporating national statistics, forecast: wiiw.

Private demand gave the main pull to economic growth in both EU accession countries in 2004 and also in the first quarter of 2005. This is true first of all for Romania where domestic demand, primarily that of households, grew by 12% (Bulgaria 5%). As outlined in the section on wages below, Romania has had particularly rapid wage expansion, while Bulgaria showed more restraint last year but less in the current election year. Government final consumption had a modest positive contribution to growth in Bulgaria and Romania in 2004, and it can be even less in 2005 in Romania while increasing in Bulgaria. As the trade deficit widened, net exports have most probably had a negative contribution to growth in both countries.

Domestic demand and export expansion fuelled the increase of industrial output in Romania and Bulgaria both in 2004 and in the first quarter of 2005 (Table 3). Manufacturing recovers this year also in Macedonia after a severe decline in the

previous one. Stagnation of the industry in Croatia and its decline in Serbia are signs of structural change but also of problematic industrial competitiveness in both countries. Privatisation to insiders has not proved advantageous as capital investments are inadequate and access to foreign markets is limited. Foreign takeovers are rare and investors are generally not keen to enter into joint ventures in Croatia. Serbia relies more on privatisation by sale, and the present decline in industrial output may be due to restructuring which can be followed by an upswing. Traditionally, the Turkish private economic activity concentrated in the primary and tertiary sectors. Industrialization was the government's job and has remained halfway. Now, the secondary sector is growing rapidly, backed by alliances between private domestic and foreign forces. In all countries of the region, with the exception of Bulgaria, services are more dynamic than industry and a construction boom is also widely present.

Table 3

Gross industrial production
real change in % against preceding year

| | | | | | | | | | | | Index 1990=100 | Index 2000=100 |
|---------------------------|------|------|------|------|--------------------|----------------|------|----------|------|-------|-------------------|-------------------|
| | 2000 | 2001 | 2002 | 2003 | 2004 ¹⁾ | 2004 | 2005 | 2005 | 2006 | | | 2004 |
| | | | | | | 1st quarter | | forecast | | | | |
| Albania ²⁾ | 0.5 | 7.1 | 1.8 | 2.7 | 3.1 | . | . | 4 | 5 | 43.8 | | 115.4 |
| Bosnia and Herzegovina | 7.9 | 4.9 | 5.7 | 5.1 | 12.1 | . | . | 7 | 10 | . | | 130.6 |
| Bulgaria ³⁾ | 8.3 | 1.5 | 6.5 | 14.1 | 18.3 | 14.8 | 11.1 | 10 | 8 | 77.4 | | 146.0 |
| Croatia | 1.7 | 6.0 | 5.4 | 4.1 | 3.7 | 5.6 | 0.3 | 2 | 3 | 77.4 | | 120.6 |
| Macedonia | 3.0 | -3.1 | -5.3 | 4.7 | -2.2 | . | 4.8 | 3 | 5 | 49.7 | | 94.0 |
| Romania | 7.1 | 8.3 | 4.3 | 3.1 | 5.3 | 5.9 | 5.3 | 5 | 5 | 75.2 | | 122.7 |
| Serbia | 11.4 | 0.1 | 1.8 | -3.0 | 7.1 | 9.5 | -3.4 | 3 | 5 | . | | 105.9 |
| Montenegro | 4.3 | -1.0 | 1.1 | 2.1 | 13.8 | -1.7 | 3.9 | 5 | 5 | . | | 116.2 |
| Turkey | 6.0 | -7.5 | 9.4 | 7.8 | 9.8 | 10.4 | 6.2 | 6 | 8 | 181.1 | | 119.7 |

Notes: 1) Preliminary. - 2) According to gross value added. - 3) For quarterly data-enterprises with more than 10 employees.

Source: wiiw Database incorporating national statistics, forecast: wiiw

Based on the above trends one can conclude that in 2005 Southeast Europe is expected to grow somewhat less dynamically than in 2004. A deceleration of growth characterizes first of all the largest economies of the region, Turkey, Romania, Croatia and Serbia. Only two smaller countries, Macedonia and Montenegro that were lagging behind earlier will likely grow faster. There are indications, that in most countries both investments and private consumption grow slower than in the previous year. Public consumption will decline further and net exports may become even more negative. Growth deceleration will not stop the catching-up process as all countries but Croatia will grow at a rate between 4% and 6% in 2005 and probably also in 2006.

Inflation coming down, wages low but increasing

Inflation has been low or slightly descended in seven countries of the region increasing only in Croatia and Serbia (Table 4). Fixed exchange rates and widespread euroization mean that most prices of tradables follow the European trend and hardly increase. Bosnia-Herzegovina and Macedonia have enjoyed price stability for some time; inflation is low and decreasing in Albania. It is also low in Croatia but in 2005 it will probably increase in comparison to the previous year. Romania and Turkey have the highest rate consumer price increase, but inflation is coming down below 10% this year. In Romania where wages have expanded very rapidly, one cannot observe an acceleration of inflation albeit the growth

of government administered energy prices. But prices not covered by the consumer price index, like those of new dwellings, skyrocketed in the last few years. The acceleration of inflation in Serbia, which started anew last year, continued in the first quarter of 2005. This can be associated with the rapid expansion of wages and the generated demand as well as with currency depreciation.

Real wages have increased in many countries of the region quite rapidly in recent years (Table 5). In Albania, Romania and Serbia they increased at or close to double digit pace and this trend even accelerated in the first quarter of 2005. Wage expansions are far more rapid than the increase of GDP and may support inflation or a deterioration of the trade balance.

Relatively low euro wages are the advantage of Bulgaria when it comes to attracting labour intensive manufacturing. Romania has lost some of its attractiveness after the recent wage rises and appreciation of the local currency (Annex Table A3). Albania and Serbia also have low wages, but other factors of doing business are not favourable. In countries whose currencies are fixed and wages increase rapidly, wages are significantly higher in euro terms compared to the rest of the region. Therefore production is more costly than in the rest of region in Bosnia and Herzegovina, in Croatia and in Montenegro. These countries will probably not attract labour intensive export oriented manufacturing FDI and will have to find an alternative growth path if the current trend holds on.

Table 4

Consumer price inflation
change in % against preceding year

| | 2000 | 2001 | 2002 | 2003 | 2004 ¹⁾ | 2004 | 2005 | | 2005 | 2006 |
|------------------------------------|------|------|------|------|--------------------|----------------|------|--|----------|------|
| | | | | | | 1st quarter | | | forecast | |
| Albania | 0.1 | 3.1 | 5.2 | 2.3 | 2.9 | 3.9 | 2.2 | | 2.5 | 2.5 |
| Bosnia & Herzegovina ²⁾ | 4.8 | 3.1 | 0.4 | 0.6 | 0.4 | 0.4 | . | | 0.5 | 0.5 |
| Bulgaria | 10.3 | 7.4 | 5.8 | 2.3 | 6.2 | 6.4 | 3.8 | | 4 | 4 |
| Croatia ³⁾ | 6.2 | 4.9 | 1.7 | 1.8 | 2.1 | 1.8 | 3.3 | | 3 | 2.5 |
| Macedonia | 5.8 | 5.5 | 1.8 | 1.2 | -0.4 | 1.6 | -0.4 | | 2 | 2 |
| Romania | 45.7 | 34.5 | 22.5 | 15.3 | 11.9 | 13.6 | 8.8 | | 9 | 7 |
| Serbia | 79.6 | 93.3 | 16.6 | 9.9 | 11.4 | 8.6 | 16.0 | | 15 | 10 |
| Montenegro ²⁾ | 22.9 | 22.8 | 17.6 | 7.8 | 3.3 | 6 | 3.6 | | 3 | 3 |
| Turkey | 54.9 | 54.4 | 45.0 | 25.3 | 10.6 | 9.5 | 8.6 | | 8 | 6 |

Notes: 1) Preliminary. - 2) Retail prices. - 3) Up to 2001 retail prices.

Source: wiiw Database incorporating national statistics, forecast: wiiw

Table 5

Real net wages
change in % against preceding year

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | | 2004 | 2005 |
|------------------------------------|------|------|------|------|-------|------|------|--|------------------------|------|
| | | | | | | | | | 1st quarter | |
| Albania ¹⁾ | -0.2 | 9.9 | 17.7 | 11.6 | 8.1 | 6.0 | 11.2 | | . | . |
| Bosnia & Herzegovina ¹⁾ | . | 9.7 | 4.0 | 14.8 | -0.6 | 7.3 | . | | . | . |
| Bulgaria ¹⁾ | 20.7 | 6.9 | 1.3 | -0.5 | 1.5 | 3.7 | -1.9 | | 0.0 | 5.5 |
| Croatia | 6.0 | 10.1 | 3.4 | 1.6 | 3.1 | 3.8 | 3.7 | | 4.3 | 1.7 |
| Macedonia | 3.8 | 3.6 | -0.3 | -1.9 | 5.0 | 3.6 | 4.4 | | 2.1 | 2.9 |
| Romania | 3.4 | -3.8 | 4.6 | 4.9 | 2.1 | 10.7 | 9.5 | | 9.0 | 13.1 |
| Serbia | . | . | 5.5 | 16.5 | 29.9 | 14.0 | 11.1 | | 5.0 | 16.5 |
| Montenegro | . | . | . | . | . | 9.3 | 9.6 | | . | 5.7 |
| Turkey ²⁾ | . | . | -3.9 | -23 | -10.9 | 11.9 | 1.0 | | 3.4 | . |

Notes: 1) Real gross wages. - 2) Real gross wages in manufacturing industry.

Source: wiiw Database incorporating national statistics.

Unemployment high and hardly changing

Low participation and high unemployment rates are lasting characteristics of the Western Balkans (Table 6)³. The situation is worst in Bosnia and Herzegovina, where about 40% of the workforce is registered jobless, but the real unemployment rate had there been a labour force survey could be about half of that. In Macedonia the strict stabilization policy has depressed output and employment. The unemployment rate peaked at 37% in 2004 and is expected to decline slowly as a result of resumed economic growth in 2005. The situation is still much better in Serbia but the restructuring of the economy triggers an increase in unemployment also in this country. Serbia is now heading towards 20% rate of unemployment where Bulgaria was five years ago. The latter country embarked on a more rapid economic growth path after privatising and

restructuring most of the economy, thus the unemployment rate is now coming down towards 10%. But the participation rate is 56% in Serbia while below 50% in Bulgaria - a perhaps only temporary advantage of Serbia.

The lowest unemployment rate together with a relatively high participation rate can be found in Romania. Fast economic growth has increased employment, mainly in construction and trade. Unemployment stagnates at about 8% despite major layoffs when former state owned enterprises are restructured. A lasting problem is the severe underemployment in rural areas. Low rate of unemployment and hidden underemployment is a problem in Turkey as well and the overall employment situation is worse than in Romania. The participation rate is very low and unemployment increases slowly due to demographic reasons despite the fast economic growth rate.

³ We do not have exact knowledge either about the size of illegal employment and or about the importance of underemployment in the public or socially owned sector - therefore it is unclear whether official unemployment statistics under or overestimate the problem. All data are according to the labour force survey except for Albania and Bosnia and Herzegovina.

Table 6

Labour market, LFS definition, annual average rate in %

| | Participation rate | | | Unemployment rate | | | | | | |
|------------------------------------|--------------------|------|--------------------|-------------------|------|--------------------|----------------|------|----------|------|
| | 2002 | 2003 | 2004 ¹⁾ | 2002 | 2003 | 2004 ¹⁾ | 2004 | 2005 | 2005 | 2006 |
| | | | | | | | 1st quarter | | forecast | |
| Albania ²⁾ | . | . | . | 15.8 | 15.0 | 14.4 | 14.9 | . | 14 | 14 |
| Bosnia & Herzegovina ²⁾ | . | . | . | 40.9 | 42.0 | 42.8 | . | . | 42 | 42 |
| Bulgaria | 49.4 | 49.2 | 49.7 | 17.8 | 13.7 | 12.0 | 13.3 | 11.3 | 10.3 | 9.5 |
| Croatia | 50.9 | 50.2 | 50.5 | 14.8 | 14.3 | 13.8 | . | . | 13.5 | 13 |
| Macedonia | 52.6 | 54.5 | 52.2 | 31.9 | 36.7 | 37.2 | 37.2 | . | 35 | 35 |
| Romania ³⁾ | 56.0 | 54.8 | 54.8 | 8.4 | 7.0 | 8.0 | 8.8 | . | 7 | 7 |
| Serbia | 56.1 | 55.7 | 56 | 13.3 | 14.6 | 18.5 | . | . | 20 | 20 |
| Montenegro | . | . | . | 21.6 | 22.9 | 22.3 | . | . | 23 | 23 |
| Turkey | 49.6 | 48.3 | 48.7 | 10.3 | 10.5 | 10.3 | 12.4 | 11.7 | 10.8 | 11 |

Notes: 1) Preliminary. - 2) Unemployment by registration, end of period. - 3) From 2002 new methodology in accordance to EU definitions.

Source: wiiw Database incorporating national statistics, forecast: wiiw.

On the whole, unemployment is stubborn in the whole region but prospects are not altogether bad. The examples of Bulgaria and Romania, to some extent also of Albania show that employment can increase in the presence of very high rates of economic growth. Unfortunately we do not expect such employment-creating development in the rest of the region.

Foreign trade and current account deficits expand

High and growing foreign trade deficit is a major characteristic of South East European countries. Although exports have grown quite rapidly in some of the countries, imports have grown even faster. Exports to GDP ratio, an indicator of openness is low, below 40% except for Bulgaria, the lowest in Albania, 8% in 2004 (overview table III). Indicators around or

below 25% for Serbia, Croatia, Montenegro and Bosnia-Herzegovina indicate that the export sector is very weak and the manufacturing sector is slow to recover. As to the import side, openness is pathologically high in case of Bosnia-Herzegovina, 81%, and above 50% in not only Bulgaria but also in Macedonia and Montenegro. High import dependence together with a low ability to export adds up to a large foreign trade deficit.

The deficit of goods trade in the balance of payments is the lowest in Turkey (8% of GDP in 2004), Romania (9%) and Bulgaria (14%) (Table 7). The trend has been increasing in all three countries over the last few years. The accession countries boast with high rates of exports expansion and deepening integration into the EU. But their economic growth is import intensive, partly due to investment goods and raw materials

that come from abroad, partly due to growing demand for consumer goods. Especially Romania's imports have been boosted by soaring demand of private consumers driven by rising wages. In addition, a large part of the manufacturing exports is wage processing with low value added. First quarter 2005 data confirm the trend of rising foreign trade deficits in Bulgaria and Romania (Table 8, calculated in nominal euro). In these countries both exports and imports growth accelerated compared with the previous year. Turkey seems to switch to a healthier trend with imports growing less than exports in the first quarter but the two growth rates may become more similar later in the year and in absolute terms the trade deficit will continue to widen.

Five other countries of the region have a trade deficit between 20% and around 30% of GDP (Table 7). The lower end is represented by Albania where exports rise impressively albeit from a very low level. Serbia has the highest deficit and largest increase in 2004 but this will be corrected in 2005 as the growth rate of exports will likely exceed that of imports (Table 8). The same is true for Montenegro. In Croatia the foreign trade deficit came down somewhat in 2004 but it is on the rise again in 2005.

In all countries, the current account deficit is fortunately much smaller than the trade deficit of goods (Tables 7 and 9). Some countries have very positive balances of services. From tourism Croatia has the most significant earnings and these are also rising

Table 7

Current account
in % of GDP, based on EUR

| | Balance on goods | | | Balance on services | | | Balance on incomes | | | Balance on transfers | | |
|----------------------|------------------|-------|-------|---------------------|------|------|--------------------|------|------|----------------------|------|------|
| | 2002 | 2003 | 2004 | 2002 | 2003 | 2004 | 2002 | 2003 | 2004 | 2002 | 2003 | 2004 |
| Albania | -23.9 | -21.9 | -19.6 | -0.1 | -1.4 | -0.6 | 2.6 | 2.8 | 2.2 | 12.9 | 13.7 | 13.6 |
| Bosnia & Herzegovina | -59.2 | -58.4 | -55.4 | 3.3 | 3.7 | 4.5 | 9.1 | 7.5 | 5.4 | 24.6 | 22.7 | 22.2 |
| Bulgaria | -10.2 | -12.5 | -14.0 | 2.9 | 3.0 | 3.7 | -1.7 | -3.2 | -1.8 | 3.4 | 3.5 | 4.6 |
| Croatia | -24.6 | -27.3 | -24.3 | 13.6 | 19.8 | 17.7 | -2.4 | -4.2 | -2.2 | 4.8 | 4.9 | 4.3 |
| Macedonia | -21.3 | -18.4 | -20.9 | -0.6 | -0.1 | -0.8 | -0.8 | -0.7 | -0.7 | 13.2 | 15.9 | 14.7 |
| Romania | -5.7 | -7.8 | -9.0 | 0.0 | 0.1 | -0.4 | -1.0 | -2.4 | -2.3 | 3.3 | 4.0 | 4.2 |
| Serbia | -24.7 | -24.2 | -31.7 | 1.9 | 1.5 | 1.8 | -0.7 | -1.1 | -1.0 | 10.0 | 12.1 | 15.3 |
| Montenegro | 32.7 | 25.1 | 28.1 | 7.6 | 7.8 | 9.1 | 5.8 | 6.9 | 6.8 | 6.7 | 3.2 | 2.9 |
| Turkey | -4.0 | -5.8 | -7.9 | 4.3 | 4.4 | 4.2 | -2.5 | -2.3 | -1.8 | 1.3 | 0.4 | 0.4 |

Source: WIIW Database incorporating national statistics.

in Montenegro. As a result, services trade shows an 18% of GDP surplus in Croatia and 9% in case of Montenegro in 2004. While it seems that the Croatian tourism revenues have levelled out, there is some room for increase in the latter country. Turkey has a large tourism industry, but net services revenues amount only to 4.2% of GDP, similar to Bosnia and Herzegovina or Bulgaria.

Another major foreign revenue for several countries comprises transfers, i.e. remittances of people working abroad. In 2004 transfers amounted to 22% of GDP in case in Bosnia and Herzegovina, 15% for

Macedonia and Serbia and 14% for Albania. They are on the increase in Serbia while stagnating or falling in the other countries. Emigration and foreign employment of Bulgarian and Romanian citizens is of smaller scale and more recent than from the former Yugoslav countries; transfers of earnings from abroad are constantly growing and amount to 4-5% of GDP. Turkish data on transfers, 0.4% of GDP, are very modest if compared with the large size of diaspora in Europe. But there is a huge amount of unclassified capital inflow in the balance of payments booked as errors and omissions, in part hiding remittances.

Table 8
Foreign Trade
cumulated data within respective period, based of customs statistics

| | | Exports total (fob) | | | | | | | | |
|-------------------------|----------------|----------------------------|----------------|-----------------|----------------|-------------|----------------|-----------------|----------------|-------------|
| | | I Q 2003 | I-II Q 2003 | I-III Q 2003 | I-IV Q 2003 | I Q 2004 | I-II Q 2004 | I-III Q 2004 | I-IV Q 2004 | I Q 2005 |
| Albania | EUR mn | 101 | 204 | 303 | 401 | 109 | 238 | 360 | 486 | 121 |
| | change in % | 16.5 | 23.8 | 19.7 | 14.7 | 7.8 | 16.8 | 18.9 | 21.3 | 11.1 |
| Bosnia & Herzegovina | EUR mn | 260 | 602 | 955 | 1303 | 357 | 760 | 1197 | 1677 | . |
| | change in % | 9.0 | 15.5 | 14.7 | 11.5 | 37.3 | 26.2 | 25.4 | 28.7 | . |
| Bulgaria | EUR mn | 1635 | 3252 | 5004 | 6668 | 1719 | 3618 | 5807 | 7994 | 2078 |
| | change in % | 20.5 | 15.0 | 10.9 | 10.0 | 5.1 | 11.3 | 16.0 | 19.9 | 20.8 |
| Croatia | EUR mn | 1364 | 2696 | 4002 | 5468 | 1452 | 3042 | 4727 | 6451 | 1491 |
| | change in % | 15.5 | 6.8 | 4.2 | 5.4 | 6.5 | 12.8 | 18.1 | 18.0 | 2.7 |
| Macedonia | EUR mn | 274 | 588 | 890 | 1206 | 293 | 598 | 960 | 1343 | 364 |
| | change in % | -1.6 | 4.0 | 1.5 | 2.4 | 6.9 | 1.7 | 7.9 | 11.4 | 24.4 |
| Romania | EUR mn | 3778 | 7501 | 11574 | 15614 | 4337 | 9033 | 13995 | 18935 | 5091 |
| | change in % | 14.4 | 8.2 | 7.6 | 6.4 | 14.8 | 20.4 | 20.9 | 21.3 | 17.4 |
| Serbia | EUR mn | 576 | 1173 | 1812 | 2397 | 544 | 1228 | 2033 | 2943 | 753 |
| | change in % | 22.3 | 18.4 | 14.1 | 11.0 | -5.5 | 4.7 | 12.2 | 22.8 | 38.4 |

| Imports total (cif) | | | | | | | | | | |
|-------------------------|----------------|-------------|----------------|-----------------|----------------|-------------|----------------|-----------------|----------------|-------------|
| | | I Q 2003 | I-II Q 2003 | I-III Q 2003 | I-IV Q 2003 | I Q 2004 | I-II Q 2004 | I-III Q 2004 | I-IV Q 2004 | I Q 2005 |
| Albania | EUR mn | 384 | 802 | 1218 | 1648 | 380 | 827 | 1302 | 1851 | 417 |
| | change in % | 4.6 | 5.1 | 5.2 | 3.6 | -1.0 | 3.0 | 6.9 | 12.3 | 9.7 |
| Bosnia & Herzegovina | EUR mn | 1045 | 2332 | 3654 | 4974 | 1051 | 2421 | 3855 | 5354 | . |
| | change in % | 3.5 | 8.2 | 8.7 | 6.0 | 0.6 | 3.8 | 5.5 | 7.6 | . |
| Bulgaria | EUR mn | 2084 | 4541 | 6933 | 9611 | 2412 | 5330 | 8204 | 11617 | 2959 |
| | change in % | 17.1 | 17.1 | 16.5 | 14.3 | 15.8 | 17.4 | 18.3 | 20.9 | 22.7 |
| Croatia | EUR mn | 2752 | 5982 | 9176 | 12546 | 2919 | 6483 | 9855 | 13338 | 3076 |
| | change in % | 12.5 | 9.9 | 10.2 | 10.8 | 6.1 | 8.4 | 7.4 | 6.3 | 5.4 |
| Macedonia | EUR mn | 496 | 1009 | 1499 | 2037 | 493 | 1087 | 1665 | 2332 | 530 |
| | change in % | -2.1 | 0.0 | -0.6 | -3.3 | -0.6 | 7.8 | 11.1 | 14.5 | 7.4 |
| Romania | EUR mn | 4541 | 9814 | 15129 | 21201 | 5482 | 11992 | 18644 | 26281 | 6642 |
| | change in % | 9.3 | 10.5 | 10.6 | 12.3 | 20.7 | 22.2 | 23.2 | 24.0 | 21.2 |
| Serbia | EUR mn | 1531 | 3117 | 4692 | 6484 | 1893 | 3996 | 6099 | 8852 | 1667 |
| | change in % | 14.0 | 14.1 | 10.9 | 11.0 | 23.6 | 28.2 | 30.0 | 36.5 | -12.0 |
| Trade balance | | | | | | | | | | |
| | | I Q 2003 | I-II Q 2003 | I-III Q 2003 | I-IV Q 2003 | I Q 2004 | I-II Q 2004 | I-III Q 2004 | I-IV Q 2004 | I Q 2005 |
| Albania | EUR mn | -283 | -598 | -915 | -1247 | -271 | -588 | -942 | -1365 | -296 |
| Bosnia & Herzegovina | EUR mn | -784 | -1731 | -2699 | -3671 | -694 | -1661 | -2658 | -3677 | . |
| Bulgaria | EUR mn | -448 | -1289 | -1929 | -2942 | -693 | -1712 | -2398 | -3624 | -881 |
| Croatia | EUR mn | -1388 | -3286 | -5174 | -7079 | -1466 | -3441 | -5128 | -6887 | -1585 |
| Macedonia | EUR mn | -222 | -420 | -609 | -830 | -200 | -489 | -705 | -989 | -165 |
| Romania | EUR mn | -763 | -2313 | -3555 | -5588 | -1146 | -2959 | -4649 | -7346 | -1552 |
| Serbia | EUR mn | -956 | -1944 | -2880 | -4086 | -1349 | -2768 | -4066 | -5909 | -914 |

Note: Albania, Bosnia and Herzegovina: Data refer to balance of payments statistics.
Source: wiiw Monthly Database incorporating national statistics; IMF for Albania.

Taking all the components together, we arrive to the current account deficit to GDP rate of 23% in Bosnia and Herzegovina which is sustainable only due to foreign aid and multilateral loans (Table 9). Deficit levels of 13% in Serbia, 10% in Montenegro, around 7% in three other countries, and 5% in the rest of the region can be judged in comparison with the level of external debt situation. Running a high deficit should be a lesser problem for Romania and Macedonia which have low

and declining debt to GDP ratios (around 30%). But it is certainly a major problem for Croatia and Macedonia where debts piled up to 82% and 80% of GDP respectively. Even the net debt (gross debt minus National Bank reserves) of Croatia is high, 60% of GDP, which calls for a policy adjustment. High debt is due primarily to increasing private borrowing from abroad and the stability of the exchange rate discussed below.

Table 9

Foreign financial position
end of period, in % of GDP EUR based

| | Gross external debt ¹⁾ | | | Reserves of National Bank (excluding gold) ²⁾ | | | Current account | | | |
|----------------------|-----------------------------------|------|------|--|------|------|-----------------|-------|----------|-------|
| | 2002 | 2003 | 2004 | 2002 | 2003 | 2004 | 2003 | 2004 | 2005 | 2006 |
| | | | | | | | | | forecast | |
| Albania | 22.0 | 20.6 | . | 15.9 | 15.0 | 15.4 | -6.7 | -4.4 | -5 | -4 |
| Bosnia & Herzegovina | 36.8 | 32.7 | 30.7 | 21.2 | 22.6 | 26.6 | -24.5 | -23.3 | -21.4 | -18.8 |
| Bulgaria | 65.1 | 60.2 | 63.0 | 13.1 | 14.4 | 17.0 | -9.2 | -7.4 | -7.5 | -6.4 |
| Croatia | 62.2 | 77.6 | 82.1 | 23.3 | 25.7 | 23.3 | -6.9 | -4.5 | -4.4 | -4.5 |
| Macedonia | 37.7 | 34.5 | 33.4 | 17.3 | 17.5 | 15.4 | -3.3 | -7.7 | -6.6 | -6.3 |
| Romania | 30.9 | 31.3 | 30.7 | 12.1 | 12.6 | 18.4 | -6.0 | -7.5 | -8.3 | -7.4 |
| Serbia | 71.2 | 64.7 | 57.9 | 13.7 | 16.3 | 16.8 | -9.2 | -13.1 | -14 | -13 |
| Montenegro | . | 65.7 | 80.4 | . | . | . | -7.4 | -9.7 | -5 | -5 |
| Turkey | 70.9 | 60.5 | 53.5 | 13.9 | 13.4 | 11.4 | -3.3 | -5.1 | -5 | -5 |

Notes: 1) General government foreign debt for BiH; Macedonia and Romania medium- and long-term debt. - 2) Albania: including gold; refer to total foreign assets of Bank of Albania.

Source: WIIW Database incorporating national statistics, forecast: WIIW

Turkey has in the last four years successfully come out from the default. Foreign debts to GDP are declining, the current account deficit is moderate, but reserves could be higher. The prospects for the country are quite good and one cannot expect another default. The other country of the region which went through a currency crises a few years earlier than Turkey is Bulgaria which has an improving net debt position under the currency board regime since 1997. Staying with the currency board

until joining the EMS seems to be a feasible policy.

FDI could be a non-debt creating way of financing the current account deficit. This was achieved in Albania, Bulgaria and Romania in 2004 (Table 10). But inflows fluctuate year-by-year according to the availability of major privatisation deals and a high level of deficit financing is possible only as long as there are state assets to be sold.

Table 10

FDI inflow to SEE, EUR million

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2004 | 2005 |
|------------------------|------|------|------|------|------|----------|---------|---------|
| | | | | | | forecast | in % CA | in % CA |
| Albania | 155 | 232 | 151 | 158 | 275 | 400 | 95.8 | 111.1 |
| Bosnia and Herzegovina | 159 | 133 | 282 | 338 | 400 | 400 | 25.9 | 26.7 |
| Bulgaria | 1103 | 903 | 980 | 1851 | 2114 | 1800 | 146.1 | 112.5 |
| Croatia | 1142 | 1503 | 1195 | 1788 | 921 | 1000 | 73.7 | 76.9 |
| Macedonia | 189 | 493 | 83 | 84 | 122 | 100 | 36.5 | 33.3 |
| Romania | 1147 | 1294 | 1212 | 1946 | 4098 | 3500 | 93.1 | 58.3 |
| Serbia | 55 | 186 | 502 | 1197 | 775 | 800 | 33.1 | 32.0 |
| Montenegro | . | 11 | 89 | 39 | 50 | . | 35.0 | . |
| Turkey | 1855 | 3684 | 621 | 367 | 2199 | 2000 | 17.6 | 14 |

Note: CA means current account deficit.

Remarks: Albania: equity capital.

Bosnia and Herzegovina: equity capital.

Bulgaria: equity capital + reinvested earnings + loans.

Croatia: equity capital + reinvested earnings + loans.

Macedonia: equity capital.

Romania: equity capital + reinvested earnings from 2003 + loans.

Serbia: FDI net (inflow minus outflow).

Montenegro: FDI net (inflow minus outflow).

Source: National banks of respective countries according to balance of payments statistics.

Managing the exchange rate and capital inflows

Five SEECs have currencies with fixed exchange rates to the euro: Bulgaria and Bosnia-Herzegovina run a currency board, Macedonia and Croatia (unofficially) maintain a peg, Montenegro (and Kosovo) uses the euro as a legal tender. Four countries have more flexible exchange rate regimes. Serbia has an unannounced crawling peg system, similarly to Romania up to recently meaning that the Central Bank allows a depreciation somewhat below the consumer price index and guides the floating exchange rate towards an unannounced target. This target is given up in case of an unexpected shock like in Romania when appreciation started. This country is about to switch to even more free flotation. Inflation targeting is the name of the monetary policy now applied in Romania, Turkey and Albania which is associated with free floating exchange rate regimes.

With the fixed exchange rate countries can buy stability, but still their inflation is usually higher than in the Euro zone and the real appreciation may erode their competitiveness. More flexible exchange rate systems usually go hand in hand with higher inflation. These regimes allow the depreciation of the local currency that may help maintain international price competitiveness. But capital inflows can also appreciate a currency and thus work against the current account balance. This has been the case in Romania since October

2004 and to a lesser extent also in Albania. Also the Croatian and the Bulgarian currencies appreciated in real terms in 2004 and in the first quarter of 2005. But only Croatia has problems with exporting while the Bulgarian currency still seems undervalued. Serbia is similar to Romania of the late 1990s with inflation and depreciation supporting each other. While most of the Southeast European countries have relied on the currency peg when suppressing inflation, Romania improved fundamentals gradually, by which also inflation came down. It is to be seen what steps the Serbian authorities will take if the current trend of widening current account deficit and accelerating inflation continues.

Investment risk has declined in the accession countries and in Croatia. Appreciating currencies together with high domestic interest rates attract investments and help accumulate private sector debts (Tables 9 and 11). Looking at the composition of foreign debt one can observe the increasing share of private debt in total foreign debt in all three countries (Fig 2). Foreign banks which are the main owners of local commercial banks are especially active in borrowing abroad cheap and investing in the host country thus earning on the interest rate differential. They extend credits less to the companies than to households or buy government securities. Lending to households and mortgage loans have been striving businesses in recent years.

Table 11

Exchange rate development, 2003-2005

11a

Nominal exchange rates per EUR, growth rate year-on-year ¹⁾

| | I Q 2003 | II Q 2003 | III Q 2003 | IV Q 2003 | I Q 2004 | II Q 2004 | III Q 2004 | IV Q 2004 | I Q 2005 |
|-----------|-------------|--------------|---------------|--------------|-------------|--------------|---------------|--------------|-------------|
| Bulgaria | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Croatia | -2.7 | -0.7 | -0.1 | 0.2 | 1.6 | 2.3 | 2.0 | 2.5 | -1.3 |
| Macedonia | 0.2 | 0.1 | 0.0 | 0.1 | 0.6 | 0.5 | 0.4 | 0.4 | 0.2 |
| Romania | 25.7 | 22.1 | 15.1 | 18.8 | 13.9 | 8.7 | 9.6 | 0.4 | -8.6 |

Notes: 1) Quarterly data are averages of monthly rates.

Source: wiiw Monthly Database incorporating national statistics.

11b

Real rates per EUR, PPI based - growth rate year-on-year ¹⁾

| | I Q 2003 | II Q 2003 | III Q 2003 | IV Q 2003 | I Q 2004 | II Q 2004 | III Q 2004 | IV Q 2004 | I Q 2005 |
|-----------|-------------|--------------|---------------|--------------|-------------|--------------|---------------|--------------|-------------|
| Bulgaria | -5.6 | -2.4 | -3.4 | -3.7 | -1.5 | -4.8 | -4.5 | -3.2 | -2.6 |
| Croatia | 0.1 | 1.0 | 0.9 | 2.4 | 0.6 | -2.5 | -3.7 | -3.0 | -2.8 |
| Macedonia | 0.6 | 2.2 | 2.7 | 2.9 | 2.9 | 1.9 | 1.0 | 1.2 | 1.3 |
| Romania | 4.8 | 2.4 | -1.6 | 0.0 | -3.3 | -7.2 | -7.0 | -12.2 | -16.7 |

Notes: 1) Minus means real appreciation.

Source: wiiw Monthly Database incorporating national statistics.

11c

Real rates per EUR, CPI based - growth rate year-on-year ¹⁾

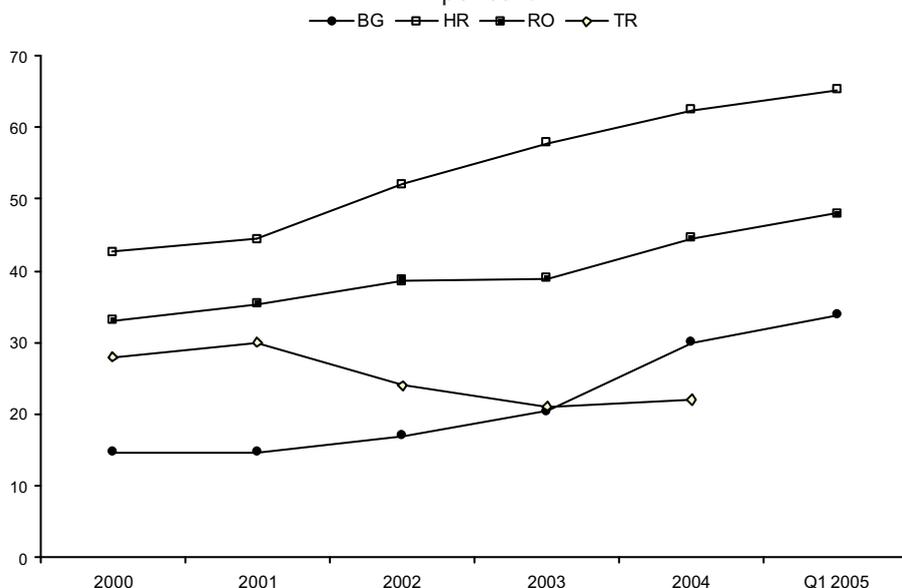
| | I Q 2003 | II Q 2003 | III Q 2003 | IV Q 2003 | I Q 2004 | II Q 2004 | III Q 2004 | IV Q 2004 | I Q 2005 |
|-----------|-------------|--------------|---------------|--------------|-------------|--------------|---------------|--------------|-------------|
| Bulgaria | 2.0 | 1.2 | -0.7 | -2.3 | -4.2 | -4.0 | -4.0 | -2.1 | -1.4 |
| Croatia | 2.5 | 3.1 | 2.2 | 2.9 | 0.5 | -1.3 | -1.0 | -0.8 | -2.0 |
| Macedonia | 1.0 | 0.6 | -0.6 | 0.0 | -0.2 | 1.9 | 2.0 | 1.9 | 1.9 |
| Romania | 10.5 | 8.7 | 2.3 | 5.6 | 2.2 | -0.8 | 0.4 | -6.3 | -13.9 |

Notes: 1) Minus means real appreciation.

Source: wiiw Monthly Database incorporating national statistics.

Figure 2

Share of private foreign debt in total foreign debt, 2000-2005
in per cent



Source: National banks of respective countries.

Central banks are concerned about the excessive capital inflows and the fast increase of lending to the population. Capital inflows increase the current account deficit or if not sterilized they can increase inflation. But with currency boards or pegged exchange rates in place, central banks have very few monetary policy instruments at hand. Bulgaria and Croatia try to influence the credit activity of the commercial banks by raising the reserve requirements. Romania was concerned about the domestic credit expansion early last year and increased the lead interest rate. Later on the authorities became more concerned about capital inflows and worked on lowering the interest rate. The absence or limited availability of monetary policy instruments together with a fixed or appreciating exchange rate puts the burden of adjustment on the fiscal policy.

Fiscal policy tight

Fiscal consolidation has been a primary target throughout the region with the aim to cure high current account deficits, while only two countries have also high budget deficits. Albania and Croatia have general government deficits more than 4.5% of GDP, the rest of the countries have deficits of less than 2%, Bulgaria is running a surplus (Table 11). Budgetary austerity is the IMF-led government programme irrespectively of the size of budget balance. In the long run this policy has been very helpful to introduce fiscal discipline and improve transparency but in individual cases it proved to be over ambitious or even counterproductive.

Under the currency board regime in Bulgaria there is hardly any other tool in the hands of the authorities to curtail the current account deficit and the inflationary pressure than working on the government generated demand. The fiscal surplus over the last few years helped the country reduce its public debt from the level of default to a level earning constantly improving sovereign credit ratings. Fast structural reforms helped the country embark on a sustainable economic growth path which affected increased budgetary revenues. But expenditure tightening has curtailed public services, depressed wages and pensions and contributed to the low standard of living. The wage increases introduced at the beginning of this year despite the objections of the IMF have actually not reduced the surplus of the budget. Also Romania was at row with the IMF over the compensation of lost revenues due to the introduction of a 16% flat tax at the beginning of 2005. Also here, revenues from other sources grew fast enough to keep the deficit within the modest limit of 1 per cent of GDP.

In Croatia the public deficit is a more pressing problem. It has been high for several years and has contributed to the soaring external indebtedness. The government planned to bring down the deficit from close to 5% of GDP in 2004 to 3.7% in 2005. This seems quite impossible if only due to the deceleration of economic growth and in midyear the government has most probably softened the target. Transparency of the budget is another acute problem and methodological improvement is necessary before a more exact judgement can be made. This is certainly true also for many other countries in the region.

Macedonia has been the example of successful fiscal consolidation bringing

down the deficit from over 6% of GDP in 2001 to 1% in 2004. Arriving to a healthy budget has suppressed economic growth. Now that the resumption of growth is the main aim, the government seems to lack ideas how to stimulate growth without falling back on the fiscal side. Serbia is a more recent example of a similar budgetary consolidation policy. It has brought down the general government deficit from 4.2% of GDP in 2003 to 1.7% in 2004. The IMF programme stipulates a surplus for 2005. Fiscal austerity is a vehicle to speed up structural reforms in the still too large public sector and to press for privatisation. Subsidies and inefficient employment are to be reduced. The short-term effects of this programme have already shown up in the increasing rate of unemployment while exports recovered and economic growth accelerated.

Turkey is on an even stricter programme of the IMF, which has supported its recovery from the 2001 crisis. Budget deficit has been brought down from 16% of GDP to 8% in 2004 while it has a primary surplus of 6% of GDP. The difference is the interest payment on the huge public debt the country is servicing. Similar to the transition economies, privatisation revenues should help bring down government debt.

EU enlargement now more uncertain

Accession to the European Union in 2007 is the main goal for all political forces in Bulgaria and Romania. Also other governments in the region target EU accession in the closer or more remote future. This aspiration contributes to enforcing structural reforms and may increase political stability as well. But the European sentiment towards further EU enlargements has cooled down recently.

The outcome of the referenda on the EU constitution in France and the Netherlands interrupted the process of deepening the integration and also questioned the usefulness of further enlargements. An ebb of the integration process may start a re-thinking of the future of the European integration and solutions to pending issues may be further delayed. Dates and conditions of further enlargements could come under renewed consideration and political goodwill may no longer tolerate the lack of preparedness.

Having signed the accession treaty on April 25, 2004, Bulgaria and Romania can feel pretty safe over their future in the EU. Unilateral withdrawal of the EU from this contract is unlikely. Still there are at least two major hurdles on which the accession of the two countries on 1 January 2007 may stumble. One is the annual assessment by the Commission; the other is the ratification of the accession treaties in the parliaments of the member states.

The European Commission is expected to provide the next screening of Bulgaria and Romania in November 2005 and will detail the most sensitive aspects of the current situation. This report is expected to determine whether Bulgaria and Romania should join in 2007 or 2008. Meanwhile early warning letters arrive in the two capitals reminding the governments of areas in which further efforts are necessary. There are several chapters including competition where the governments may get a bad mark⁴. If inadequate preparedness is stated, the safeguard close by which accession would be postponed to 2008 will probably come into effect. The probability of this has

increased. Following the negative referenda on the European Constitution, the Commission will be more accurate when judging the conditions in the accession countries.

Accession delayed by one year would do not much economic harm to Bulgaria and Romania. It could in fact be used for further preparation and increasing competitiveness. While they would not be eligible for increased funds from the EU budget, their ability to draw on these funds may increase. The loss in transfers would amount to EUR 1.16 bn for Romania but only under the unlikely condition it would be able to exploit all these funds. For sure there would be disappointment in both accession countries if they do not prepare for delayed accession in due time. At the same time, delayed enlargement would come at hand for many incumbent governments. It would be albeit minor relief in the 2007-2013 EU budget that may make a compromise with the net payers easier. Some incumbent governments may also reap domestic political benefits by supporting an enlargement delay. The negative political sentiment towards enlargement in some incumbent countries may also postpone the ratification of the two accession treaties. This may not only delay accession by one year but, postpone enlargement for good. What seemed to be very unlikely just a few months ago became a real possibility under the new political circumstances.

The renewed discussion on enlargement hits all other countries in the region. Especially Turkey which was promised to get the lengthy accession

⁴ The accession treaty refers to a list of policy areas (11 for Romania and 7 for Bulgaria) in which the two countries must make significant progress before accession. In Romania, the main issues are corruption, border controls, the enforcement of state aid controls and the implementation of environmental laws. In Bulgaria, the concerns centre around judicial reforms, agriculture, environment (including the closure of the Kozloduy nuclear power plant), intellectual property rights and the free movement of services.

negotiations started as of October 2005 may have to suffer a delay. Croatia is another official candidate country. Its prospects are better as it can start the negotiation process provided cooperation with the Hague Tribunal is found satisfactory.

For countries in the Western Balkans that have made sufficient progress in terms of political and economic reform and administrative capacity, the next step is a formal contractual relationship with the EU. This takes the form of a tailor-made Stabilization and Association Agreement (SAA). To keep the process of preparation for enlargement going is essential for longer-term political stability and continued reform efforts in the region. Macedonia has already the SAA and may get a candidate status soon. In order to get the SAA, the Serbian government first of all has to improve cooperation with the Hague Tribunal. It has

further the task of adopting a national strategy of accession to the EU. The unresolved status of Kosovo and the uncertain future of the union with Montenegro are additional constitutional problems that have to be solved. In Bosnia and Herzegovina local authorities do not appear enthusiastic to meet EU conditions necessary for concluding an SAA. The Serb-dominated part of the country (RS) rejected recently one of the conditions, the creation of a countrywide police force. While the lack of fulfilling political conditions seems to be the major delaying factor to sign SAAs, only a deepening cooperation with the EU and the prospect of membership can stimulate governments to solve the pending problems, guarantee stability and create conditions for sustainable economic development.

Guidelines for Authors

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The publishers warmly welcome submissions of papers. The RJEА comprises mainly articles. We also intend to develop a section of book reviews. The Romanian Journal of European Affairs may include articles that go beyond the scope of European integration topics, but are, nevertheless, intrinsically connected to them.

The ideal length of an article (written in English or French) is from 4 000 to 8 000 words, including a 200-word abstract in English or French and a very brief autobiographical note. Book reviews will be no longer than 2 000 words.

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Rien ne se crée sans les hommes. Rien ne dure
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Jean Monnet



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