

**United Nations  
Economic Commission for Europe**

**BEYOND ENLARGEMENT:  
TRADE, BUSINESS AND INVESTMENT  
IN A CHANGING EUROPE**



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## NOTE

The publication *Beyond Enlargement: Trade, Business and Investment in a Changing Europe* contains summaries of presentations, papers, quotations and parts of selected slide presentations delivered at the Workshop on “Trade, Business and Investment in a Wider Europe”, held on 7 April 2003 and papers written for the purposes of this publication.

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The majority of the presentations are available on the UNECE web site at:

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## PREFACE

After growing successfully from six to fifteen members, the European Union (EU) is now preparing for its biggest enlargement ever in terms of scope and diversity. Ten new Member States, namely Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia, will join on 1 May 2004. Romania and Bulgaria are expected to join in 2007. The enlargement to the East and South of Europe will have a great economic impact on those countries who have currently no prospects of membership but who will soon find themselves sharing their borders with the EU. The EU has recently launched a Wider Europe initiative so as to deepen its relation with the future neighbouring countries and reduce the economic and social impacts of enlargement.

Over the past 50 years, the United Nations Economic Commission for Europe (UNECE) has played an important role in fostering European integration through well-targeted economic cooperation initiatives, in many cases led by EU Member States. UNECE instruments have proved vital in facilitating trade, transit and customs matters and promoting common legal instruments for transport, energy and environment together with the other aspects of UNECE cooperation. These instruments have made a significant contribution to the success of the EU's customs union and Single Market. To address major issues regarding the new shape of relations between the enlarged EU and its future neighbouring countries, the UNECE has, with the support of the European Union, initiated a discussion on a Wider Europe through a series of the workshops.

The UNECE concept of a wider Europe shares similar aims with that of the European Union, which is to promote regional economic cooperation and integration to achieve stability and prosperity in Europe, and to assist in ensuring that no new divisions emerge in this continent. However, the EU has so far limited its scope to the future neighbouring countries, while the UNECE has included the non-acceding countries in Eastern Europe, Central Asia, the Caucasus and the Balkans, which are all member States of the UNECE.

To discuss possibilities for further integration and liberalization within the European region, enhancing trade, business and investment environment, in order to promote stability and prosperity beyond the new borders of the EU, the UNECE held a one-day **Workshop on Trade, Business and Investment in a Wider Europe** on 7 April 2003.

The present publication is based on the presentations and contributions to the Workshop and documents and papers relating to the topic. The publication presents to policy makers the opportunities for further economic integration within the region after enlargement. It also confronts non-acceding countries with some issues which would need to be addressed in order to ensure that Europe develops in a positive manner, promoting sustainable prosperity throughout the continent.

This publication provides a basis for further discussions on such important topics as the future integration process in the region. The UNECE serves as a platform for all its 55 member States in promoting this process, encouraging inclusiveness and contributing to building peace and stability throughout the region.

Brigita Schmögnerová  
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## LIST OF ABBREVIATIONS

CAP	Common Agricultural Policy
CEEC	Central and Eastern European Countries
CEES	Common European Economic Space
CEFTA	Central European Free Trade Agreement
CIS	Commonwealth of Independent States
COMECON	Council for Mutual Economic Assistance
CTIED	Committee for Trade, Industry and Enterprise Development
EC	European Community
EDI	Electronic Data Interchange
EEA	European Economic Area
EEC	European Economic Community
EFTA	European Free Trade Association
EMAs	Euro-Mediterranean Agreements
EMP	Euro-Mediterranean Partnership
EMU	European Monetary Union
EU	European Union
FDI	Foreign Direct Investment
FTAs	Free Trade Agreements
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IGC	Inter-governmental Conference
ILO	International Labour Organization
IMF	International Monetary Fund
MENA	Middle East and North Africa
MFN	Most Favoured Nation
NATO	North Atlantic Treaty Organization
OECD	Organisation for Economic Co-operation and Development
PCA	Partnership and Cooperation Agreement
PPP	Purchasing Power Parity
RTAs	Regional Trade Arrangements
SAA	Stabilisation and Association Agreement
SAP	Stabilisation and Association Process
SMEs	Small and Medium-sized Enterprises



TBT	Technical Barriers to Trade
TIR	International Road Transport
TRIPS	Trade-Related Aspects of Intellectual Property Rights
UN	United Nations
UNECE	United Nations Economic Commission for Europe
UN/EDIFACT	United Nations Electronic Data Interchange for Administration, Commerce and Transport
UNCTAD	United Nations Conference on Trade and Development
UNU/CRIS	United Nations University, Centre for Regional Integration Studies, Bruges
WIPO	World Intellectual Property Organization
WTO	World Trade Organization



## *Part I*

# *WIDER EUROPE: GLOBALIZATION AND TRADE*

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“Enlargement opens up new opportunities for the EU to enhance existing co-operation with its neighbours, promoting stability, prosperity and security beyond the new borders of the EU. Experience gained by new Member States can now be shared with their neighbours across the external borders of the Union.”

*(Mr. Gunther Verheugen, Commissioner for Enlargement, European Commission, Brussels)*

Democracy and peace play an important role in the European region. Cooperation between the United Nations Economic Commission for Europe and the European Commission is thus fundamental for the future of Europe. Particularly important is the historical experience of the EU whose roots go back to immediately after World War II in order to ensure peace and security in the region. The UNECE since its establishment has provided a neutral discussion forum between East and West. Today, the UNECE serves as a balanced link between regional integration on the one hand and globalization on the other. The Workshop provides a useful opportunity to exchange views and opinions about future cooperation of the enlarged EU with the non-acceding countries and further integration in Europe, which should ensure sustainable development in the region.

*(excerpted from the introductory remarks of Mr. Dusan Sidjanski, President, Centre Européen de la Culture, Geneva, at the Workshop on Trade, Business and Investment, Geneva, 7 April 2003)*

## *A Wider Europe in the Context of Globalization and Regionalism*

***Ms. Brigita Schmögnerová,***

*Executive Secretary of the United Nations Economic Commission for Europe*

The UNECE works towards creating a supportive environment for trade, industrial and enterprise activities, and assisting in the integration of all countries – particularly the emerging market economies - into the European and global economy.

The enlargement of the European Union in 2004 to include 10 new members will greatly change the framework for trade, business and investment in the region. The enlarged Union will have more than 450 million inhabitants. Its frontier will shift dramatically to the south and to the east.

The Workshop on “Trade, Business and Investment in a Wider Europe” is aimed at exploring the shape and direction of economic integration in the region in the next decade and provides a valuable opportunity to think beyond the process of EU enlargement and the WTO trade negotiations.

### **UNECE’s historical contribution to European integration**

UNECE has for over 55 years been promoting cooperation in Europe. It was UNECE that originally drew up the European Union’s Single Administrative Document, which has become the cornerstone of international trade in Europe. The European integrated railways networks, and the motorway network, are also brainchildren of UNECE. Both have greatly eased the movement of goods, people and ideas throughout Europe. In trade and transport facilitation, Electronic Data Interchange (EDI), UN/EDIFACT (Electronic Data Interchange for Administration, Commerce and Transport) and the TIR Convention, are just a few examples of UNECE work.

During the period of the Cold War, UNECE was the only forum in which the two diametrically opposite systems could engage in dialogue and discuss economic cooperation. It was through this dialogue that UNECE was able to acquire intrinsic knowledge of the central and eastern European economies. It has been able to accumulate long time series of data and interpretations that provide a historical dimension indispensable to understanding the transition process. The annual studies produced by UNECE are valuable for decision makers at all levels of the government administration as well as for the business community and for scholars.

### **UNECE and EU enlargement**

Today, we are facing new challenges and opportunities in the European region, with the political map due to be redrawn once again after EU enlargement. This enlargement will create particular challenges for the new neighbouring countries. UNECE wants to help in seeking solutions and bridging the gaps between the enlarged EU and the rest of Europe, especially South-Eastern European countries, Russia and other CIS countries.

Already the EU is one of the biggest strategic players in the UNECE. The enlarged EU will be an even more important economic pole. UNECE sees the integration process within the context of a wider Europe as a building block for the future of a stable, prosperous and secure Europe.

The EU's new neighbouring countries should be further integrated into the enlarged EU and cooperate more intensively among themselves. Building a free trade area in a wider Europe that could eventually extend the Single Market would ensure the prospects of prosperity and security in Europe.

### **Enlargement: Central and Eastern Europe, Russia, the CIS, the Southern Mediterranean countries and the EU**

As of 1 May 2004, the EU will consist of 25 countries. With a population of around 450 million, it will have a gross domestic product

of almost € 10,000 billion; the equivalent of more than US\$ 10 trillion. This will change fundamentally its political, geographical and economic weight on the European continent.

Regional and sub-regional cooperation and integration are preconditions for political stability and consequently economic development throughout the non-accession countries. The EU is actively promoting a wide range of bilateral and multilateral initiatives to promote trade and cooperation with the neighbouring countries.

One of UNECE's priorities is to further increase our already close cooperation with the EU's new neighbouring countries. UNECE should reinforce its efforts to support its relations with the future EU border countries - Russia, the western CIS, South East Europe and countries in the Southern Mediterranean.

Many of the lessons we have learned in supporting the transition of Central and Eastern Europe to market economies are highly relevant to the CIS. UNECE is happy to offer its assistance in all fields of its expertise, particularly in the field of harmonization of technical standards and trade-related norms.

### **Implications of EU enlargement for Russia, the CIS, particularly the central Asian countries**

Few studies have so far been undertaken to examine enlargement effects on other countries of the region, for instance, on those of Central Asia.

Russia, Ukraine, Belarus and the Republic of Moldova will obviously be the most affected, due to their more developed economic and social connections with both the EU and the acceding countries. Most discussions on the implications of EU enlargement for the CIS focus on the countries sharing a common border with one or more candidate country. However, one may assume that to the extent that Russia is affected, there will be consequences for Kazakhstan or Kyrgyzstan, as most of the countries in the region are economically interdependent.

Studies of the effects of EU enlargement on some sectors like trade, and energy in non-acceding countries forecast some short-term negative

implications that could be mitigated by increased cooperation in a Wider Europe. There is some dispute about the investment effects of EU enlargement on non-acceding countries. Most of the region's countries have already attracted FDI in their natural resources, especially hydrocarbons. New investment decisions by foreign and domestic firms, say, in Kazakhstan and Turkmenistan in this sector, will depend on the world oil price fluctuations. Since there is no obvious evidence that this will be influenced by EU enlargement, it is very uncertain that the candidate countries' accession to the EU will influence investment inflows to countries in Central Asia, particularly in the energy sector. FDI in non-acceding countries in non-energy sectors will depend on further progress in reforms in the countries and could be accelerated by prospects for an enlarged free trade area.

### **Russia as a major player in the Central Asian region**

Russia's transformation has been one of the most significant features of the last 10 years. Its future relationship with the EU is thus an issue of profound importance for Europe. Russia plays a leading role in the Central Asian region, as a legacy from the Soviet Union and also because of the scale of the Russian economy.

The so-called "successor States" have during the last decade opened up new channels of cooperation with the "outside world", but they have also renewed their links with Russia. Most of these countries depend on Russia for their trade and for the transport of gas and oil.

For instance, in 1996, Kazakhstan and Kyrgyzstan signed a quadripartite agreement with Russia and Belarus, which supplemented the existing Customs Union by providing for the coordination of economic and social-cultural policies. Kazakhstan wishes to preserve its close relationship with the CIS in spite of the fact that in 1995 it became a member of the Organization of the Islamic Conference (OIC) and the Islamic Development Bank.

Recently, on 23 February, 2003, Russian President Putin and the Presidents of Ukraine, Belarus and Kazakhstan reached an agreement on the creation of a provisional joint economic space including the four

countries mentioned before. The ultimate goal of this economic alliance will be the creation of a regional-integration arrangement with the intention not of replacing the CIS but of giving priority to economic links over political relations.

Russia and most of the CIS have Partnership and Cooperation Agreements with the EU. Currently, the EU and Russia are negotiating bilaterally to create a Common Economic Space.

### **Southern Mediterranean Countries**

Regional trade and integration is one objective of the EU's Mediterranean policy. The EU has Free Trade Agreements in place with the countries of the Southern Mediterranean within what is known as the "Barcelona process". This process has since 1995 been the framework for the EU and the Mediterranean partner countries to recognise that these countries could benefit from their geographical proximity to form a closer association to create a wider area of economic cooperation and stability.

### **South East European Countries**

As far as the South East European countries are concerned, the UNECE must concentrate its technical assistance on this sub-region, especially Albania, Bosnia and Herzegovina, Serbia and Montenegro and The former Yugoslav Republic of Macedonia. Following EU enlargement, these countries will have an even greater strategic geographical position.

The UNECE strongly supports the EU approach to these countries which has already entered the so-called "Stabilization and Association Process", offering a prospect of further integration into the EU structures to the South East European countries when they have made more progress towards peace and prosperity.



## **Conclusions**

Regional integration is a source of innovation and progress in both institutions and standards. For economic agents and member States, regional and sub-regional integration organizations provide a stepping stone towards the global economy, and can help less-advantaged countries to manage the impact of globalization. Regional and sub-regional integration can lead to the adoption of programmes or action plans to establish a set of guiding principles and commitments specific to the region and contribute to the development of global programmes.

The European market seems likely to become the world economic leader in the twenty-first century. To do so, it will have to meet several requirements, including closer integration of the economies of Western Europe, expansion into Central and Eastern and South-East Europe and association with the countries of the CIS.

The progress the EU has already made, as a uniquely successful experiment in regional integration, in building the EU-15 today and the EU-25 in 2004, will be a relevant example to other regions in two aspects: how to promote reforms in order to make integration possible as in the case of candidate countries and how to deal with globalization challenges. Regional integration is the efficient avenue through which to integrate countries into the world economy. This is an instrument to manage the complexities of our interdependent, globalised world.

The role of UNECE is becoming even more relevant in the coming years, especially in relation to the twin trends of globalization and regional integration, offering an open and accessible platform to all its 55 member States for economic integration within the framework of a wider Europe but at the same time within the future closer European and transatlantic cooperation.

## ***Trade and Economic Cooperation in a Wider Europe***

***Ms. Carol Cosgrove-Sacks***

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The dramatic political and economic changes in Europe during the last decade or so have opened up new horizons for cooperation and integration. The countries of Central and Eastern Europe, which embarked on the establishment of democratic principles and economic transformation, concluded Association Agreements with the EU leading to the prospect of becoming EU members after fulfilling all conditions, including building stable democratic institutions and implementing the *acquis communautaire*. This had a positive impact on their economic reforms, on the inflow of foreign direct investment and boosted their trade. These countries became leaders in terms of economic reform in the region. On the other hand, non-acceding countries in the region have significantly fallen behind in the process of economic development compared with the Central and Eastern European countries which will soon join the EU. The break-up of the Soviet Union and Yugoslavia, as well as other factors such as rising poverty, institutional weakness, lack of democratic processes and limited transition from planned to market economies, have also played their part in widening the gaps in the European region.

These far-reaching changes in the UNECE region significantly affect its economic development. And EU enlargement is one of the most important. Enlargement has given rise to a broad range of issues regarding economic implications for non-acceding countries and the prospects for further integration within the UNECE region. Hence, the UNECE attaches great importance to enlargement and sees this process as an opportunity to promote stability and prosperity beyond the new borders of the EU through further economic integration by

strengthening trade, increasing FDI, and by deepening cooperation in, for instance, environment, transport, energy, telecommunication and migration. The UNECE provides a neutral platform for discussing the opportunities and implications of EU enlargement and the further economic cooperation and integration of the post-enlargement Europe at its series of workshops, covering topics such as energy, trade, transport and environment.

## **EU enlargement and a wider Europe**

In May 2004, with 10 new member countries<sup>1</sup> the EU will be facing its most significant enlargement in terms of scope and diversity. EU enlargement is one of the most important challenges and opportunities for Europe at the beginning of the twenty-first century. It will have a major impact on the EU's future political, economic and geographical influence in Europe as well as in the world at large. The borders of the EU will be significantly extended towards the south and east. What will be the impact of the enlargement on the non-acceding countries? How will the relations evolve between the EU and its new neighbouring countries and other non-acceding countries?

To bring countries, which will remain outside of the enlarged EU borders, closer to the EU and to promote regional and sub-regional integration and cooperation, the EU has recently defined its new neighbourhood policy in its Communication on a Wider Europe<sup>2</sup>. In this Communication, the EU recognized the need to build a politically and economically stable and prosperous zone within the European region through promoting cooperation and integration with the countries that will soon become its new neighbours. One of the important elements of the EU's Wider Europe policy is a "New Neighbourhood Instrument",

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<sup>1</sup> Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia

<sup>2</sup> "Wider Europe – Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours", Communication from the Commission to the Council and the European Parliament, 11.3.2003, [http://europa.eu.int/comm/external\\_relations/we/doc/com03\\_104\\_en.pdf](http://europa.eu.int/comm/external_relations/we/doc/com03_104_en.pdf)

focused on promoting cross-border regional cooperation and, in turn, aimed at promoting sustainable economic and social development. This should include further integration and liberalization to promote the free movement of goods, services, capital and persons, as the countries concerned make progress within agreed benchmarks and targets contained in individual action plans taking account of their specific circumstances. The EU has put forward a vision of upgrading political and economic relations and extending the scope of cooperation with its near eastern and southern neighbours, namely Russia, the western Newly Independent States (Ukraine, Republic of Moldova, Belarus) and the Southern Mediterranean countries. In the future, the EU is ready to consider the inclusion of the Southern Caucasus countries within this policy.

However, the new neighbourhood policy should not, according to the European Commission, alter the existing framework for EU relations with Russia and Eastern and Southern European partners, as developed in the Partnership and Cooperation Agreements, Stabilization and Association Agreements and other agreements and common strategies, such as the “Barcelona Process” to promote a Mediterranean free trade area by 2010. It should endorse and support those policies and the implementation of existing agreements remains a priority.

### **Existing arrangements between the EU and non-accessing countries**

The Stabilization and Association Process (SAP) remains the policy framework to help the Western Balkan countries<sup>3</sup> along the way and is recognized and supported by the countries in the region and by the international community. The SAP is a strategy introducing European values, principles and standards in the region, which will help to start the process of accession of the western Balkans to the EU. This process is a long-term policy offering the same pillar for reforms in those

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<sup>3</sup> Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, and Serbia and Montenegro.

countries as the accession process has had in Central and Eastern Europe and at the same time moving the western Balkans steadily towards integration with the EU. EU enlargement in 2004 will bring a new dynamic to the European integration process and consequently have an impact on the western Balkans. It should contribute to make their own prospects clearer and motivate them in carrying out the reforms, which though sometimes painful, are necessary if they wish to join the EU. The Thessaloniki Summit, held in June 2003, highlighted the EU's commitment to the European future for the western Balkans and offered them the prospect of EU membership, which would depend, however, on the progress in reforming their economies, standards of democracy, human rights record, and governance, and on promoting respect for the rule of law.

Under trade measures introduced by the EU in 2000, the EU gives the western Balkans duty-free market access for practically all goods, including agricultural products, with no quantitative restrictions, except for duty-free or preferential quotas for certain products, such as some fishery products, baby-beef and wine. Since the introduction of these measures, there has been a substantial increase in EU imports from those countries.<sup>4</sup>

A cornerstone of the EU's bilateral relations with the CIS countries is Partnership and Cooperation Agreements (PCAs). The PCAs establish an institutional, political and administrative framework to facilitate all forms of bilateral cooperation between the EU and each country in the CIS. Those agreements aim to foster trade and investment and to develop close political relations by starting a regular dialogue on political issues. The PCAs are designed to stimulate the participation of the countries concerned in a wider Europe by creating a closer relationship between the EU and its partners, thus ensuring a more stable climate for traders and investors.

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<sup>4</sup> See *Report from the Commission – The Stabilization and Association process for South-East Europe, Second Annual Report*, COM(2003) 139, p. 21-22.

The PCAs offer the business community numerous benefits: trade is carried out within the mutual most favoured nation (MFN) treatment and a large number of quantitative restrictions are removed. The PCAs help to create the conditions necessary for the establishment of the future free trade areas between the EU and its partners. They commit both parties to the agreement to avoid measures that discriminate against each other's imports. Neither partner may increase tariffs without prior consultation. The PCAs aim also to promote a convergence of the standards and certification frameworks of the CIS countries with international norms, thus facilitating the two-way flow of goods.

The new neighbourhood policy is a good basis for reinforcing the EU-Russia strategic partnership. Meanwhile, bilateral negotiations between the EU and Russia continue on the establishment of the Common European Economic Space (CEES), the concept of which should be ready by the EU-Russian summit in November 2003. Development of this space takes place in the framework of the PCA between the EU and Russia and is based on reciprocal treatment. The basic idea of the CEES is that the improvement of conditions surrounding the free movement of goods, services, capital, and also people between the EU and Russia will be good for business. The plans will set objectives and benchmarks for national political, economic and legislative reforms, with undertakings from the EU on how it shall respond when targets are met. Making a success of this initiative will be one of the most significant challenges for the EU's external policy over the coming years.

### **Implications of EU enlargement on trade with the non-accessing countries**

The EU is and will remain a major trading partner for Russia and the majority of the CIS and western Balkan countries, aside from the economic ties between these countries themselves. How will enlargement influence trade between the EU and those countries? This was one of the major themes discussed at the UNECE Workshop on "Trade, Business and Investment in a Wider Europe", held in Geneva on 7 April 2003.

Overall the EU common external tariff is lower than the individual tariffs of the acceding countries. To be specific, on average the tariffs of Estonia, Latvia and Lithuania will rise modestly but average tariff levels in Poland and Hungary (the two largest economies to join the EU in 2004) will fall significantly. In particular, tariffs on agricultural products will be lowered, in Hungary from 31 per cent and in Poland from 34 per cent to 16.2 percent. However, regarding fisheries, the majority of acceding countries will have to raise their market access tariffs on joining the EU, although Poland and Hungary will have to reduce them. This could have a negative impact on some exporting countries, such as Russia.

In addition, existing bilateral preferential trade arrangements between acceding EU Member States and non-acceding countries will have to be terminated. These include, for example, Ukrainian-Estonian, Ukrainian-Latvian, Ukrainian-Lithuanian, and Hungarian-Yugoslav free trade agreements.

EU enlargement may also disrupt cross-border trade in a number of cases, due to the introduction of the new EU visa regime; for example, that between Poland and Ukraine, between the Kaliningrad province and Lithuania and Poland, between Belarus and Poland as well as that between Russia and Estonia, Latvia and Lithuania.

### **Better integration of non-acceding countries within the European region**

UNECE research confirms that the economic implications of EU enlargement for the region as a whole will be generally positive<sup>5</sup> Specific implications of EU enlargement for those countries depend to a large extent on whether the countries concerned will benefit from a trade-creating effect or suffer from trade diversion. The general view is that if enlargement boosts economic performance in the EU as a whole,

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<sup>5</sup> See *Economic Survey of Europe 2003 No.1*, Chapter VI – Trade and Economic Transformation, United Nations Economic Commission for Europe, 2003, p. 149.

and especially if it increases the rate of economic growth in the acceding countries, it will have an expansionary impact on imports from non-acceding countries, and therefore on their gross domestic product. The extent of that impact will depend on the strength of the boost to European economic performance, the share of the non-acceding countries in total EU imports and on the ability of those countries to respond to increased demands.

Trade measures and policies already applied in the EU towards the non-acceding countries, as well as the new EU strategies and policies, may have a positive effect on EU imports from the western Balkans. However, economic operators in the non-acceding countries need to be made aware of the potential and the benefits of those trade measures. Furthermore, they need to build contacts with the counterparts in the EU and to improve distribution channels. Better conditions for attracting and promoting foreign investment might also be required in order to enhance export possibilities. Additionally, the system of sanitary and phytosanitary, and veterinary inspections generally need to be improved.

It is important to assert that trade liberalization and the adoption of common rules and standards should be a fundamental component for market integration between the enlarged EU and non-acceding countries. UNECE is actively supporting this process.

Much work also needs to be done in the field of standards and their harmonization, which are fundamental for the operators from non-acceding countries to succeed in the EU market. Harmonized standards are essential for companies to be able to source internationally materials that are needed for their supply chain. When economic operators of non-acceding countries move away from their domestic markets to compete in the EU market, their success or failure often depends on how familiar they are with the regulations and standards in export markets. Differences between standards applied in the non-acceding countries and EU would make it more difficult for companies of non-acceding countries in the EU market.

Where harmonization of technical regulations and standards is not possible immediately, UNECE experience shows that Governments and national bodies should try to create a simple and transparent framework



for adopting and applying their national technical regulations and standards and keep foreign companies informed of how to meet these requirements. Mutual confidence can be further increased by mutual recognition of national conformity assessment bodies in accordance with the requirements of an importing country. These standardization activities are carried out by a large number of international organizations, both governmental and non-governmental. UNECE work and experience in the coordination and creation of standards is indispensable and UNECE plays a major role in providing a forum for them to cooperate. UNECE has drawn up conventions, regulations and standards for international trade, agriculture, environment, transport, energy, timber, human settlement and statistics. These standards facilitate international trade and provide traders as well as consumers with guarantees of safety and quality. For example, 70 per cent of all fruit and vegetables sold in the world comply with UNECE standards. For non-acceding countries it is crucial to adopt international standards so as to make their products competitive and to increase their export capacity. UNECE is ready to offer its experience and expertise to help those countries to adopt necessary international standards.

From the regional integration point of view, harmonization of the rules of origin between the EU and non-acceding countries might also be a vital instrument for encouraging trade between EU and non-acceding countries. A significant step ahead was made by the proposal of the European Commission to the Western Balkans to extend the pan-European system of cumulation of origin, which will enhance the region's export possibilities.

The pan-European system of cumulation of origin is based on harmonization of rules of origin applied in preferential trade between the EU, the CEECs (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia) and the EFTA countries (Norway, Iceland, Liechtenstein and Switzerland). The common rules of origin in Europe entered into force on 1 January 1997 and are applied in the EU, EFTA countries and CEECs. This arrangement means that a manufacturer can use any originating input (raw material or component) from the

area in the manufacture of finished products, without running the risk of losing free trade status if it is exported within the area. For example, a manufacturer from the EU is able to source all materials from Slovakia and export the finished products not only back to Slovakia, but also to all other CEECs as well as the EFTA countries. The basic requirement of this system is that all the countries must be linked by preferential agreements so that the system would be fully operational. The objective of the system is to create an incentive for cooperation between industries and to promote the international division of labour.

Trade facilitation also plays an important role in the non-acceding countries. Benefits from trade facilitation can be particularly important for non-acceding countries with transition economies, where removal of inefficiencies may be many times more beneficial to industries than removal of tariff barriers. With the reduced costs of their transactions, these industries could enjoy greater competitiveness in international markets. Trade facilitation is also a major factor in attracting foreign investment, especially supply-chain related investment, where the existence of an efficient import and export trading process is essential<sup>6</sup>. Firstly, those countries should enlist political will to implement trade facilitation measures into their trade policy. Then, tailor-made measures and technical assistance projects should be developed for each region according to its proximity to the EU market, and taking into consideration if the region consists, for instance, of land-locked countries. Transparency, simplification and harmonization of trade procedures and information flows play a central role in this regard. Implementation of transparency in the trade procedures by the non-acceding countries will encourage greater security, which will have a beneficial effect on the fight against corruption and improve revenue generation.

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<sup>6</sup> Tom Butterly, *Trade Facilitation in a Global Trade Environment, Trade Facilitation: The Challenges for Growth and Development*, United Nations Economic Commission for Europe, 2002, p. 36.

It is essential for non-acceding countries to adopt and implement relevant trade-related legislation. Membership of those countries in the World Trade Organization (WTO) and implementation of the multilateral rules and obligations is therefore of key importance for them. WTO accession is also considered as an engine for reform and for transformation of these countries, leading to further liberalization of trade, through lowering of tariffs, adjustments of competition and state aid practices, trade-related intellectual property rights legislation and agricultural policy in order to bring their trade regimes into compatibility with the WTO rules.

Almost all the countries in South-East Europe are members of the WTO – except for Bosnia and Herzegovina, and Serbia and Montenegro, both of which are in the process of accession. Among the CIS countries, Armenia, Georgia, Kyrgyzstan and the Republic of Moldova are members of the WTO, and Azerbaijan, Belarus, Kazakhstan, Russian Federation, Ukraine and Uzbekistan are in the process of accession. Tajikistan has begun the process. Only Turkmenistan remains to take a decision about starting the accession process.

Accession to the WTO for most of these countries is important not only in the reform process of their economies but in their inclusion into the global trading environment. For some of them, it might be seen as one of the basic steps in the process of launching their accession process to the EU.

## **UNECE's wider Europe**

Since its establishment in 1947, the UNECE has encouraged greater economic cooperation among its members and serves as a regional forum for Governments to develop conventions, regulations and standards. During the cold war the UNECE was the only official bridge between East and West, a place where two diametrically opposite systems could have a dialogue on economic cooperation. It is worthwhile to highlight the significant contribution of the UNECE to the creation of the European Coal and Steel Community in 1952, by its

report<sup>7</sup> on trends in European steel production. The UNECE report concluded that steel production should be coordinated among the European steel-producers in order to prevent an overproduction of steel and at the same time to stimulate steel consumption through increased investment in the building industry or other steel-using industries. This report led to the Schuman Plan, drawn by Jean Monnet and his co-workers, and launched on 9 May 1950, on which the European Coal and Steel Community was founded, followed later by the Treaties of Rome, establishing the European Economic Community and European Atomic Energy Community, as the first steps towards the formation of the European Union.

From the very beginning, the UNECE has carried out parallel studies on both Western and Eastern Europe. Since the break-up of the socialist block, UNECE contributed to the process of transformation of ex-communist countries from planned to market economies by providing technical assistance and expertise in implementation of the economic reforms. Throughout its existence, the UNECE gained a remarkable experience in analyzing the Eastern European economies.

The facilitation of trade is a major achievement of UNECE. UNECE serves as a platform promoting the simplification, and to a large extent automation of the instruments of international trade aimed to eliminate procedural obstacles to trade and transport and to remove technical barriers to trade. This work is carried out by the UNECE Centre for the Trade Facilitation and Electronic Business (UN/CEFACT). The UNECE sets technical regulations, standards and codes for data used in international trade. For example, cities and international ports are attributed three-letter codes for easy identification of each location – the UN LOCODES, which are basic in the efficient movement of goods.

UNECE's standard-setting work – in agriculture, road transport, environment, energy, timber, and human settlements – is of key importance in supporting the economic integration of the Euro-Asian

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<sup>7</sup> Steel Division, United Nations Economic Commission for Europe, *European Steel Trends in the Setting of the World Market*, Geneva, 1949, p. 4.

region. For the future, the UNECE will work towards creating a pan-European economic space, which perhaps could serve in the future as a major instrument of further integration process with the Eastern European countries aimed at supporting stability and long-term economic growth for the benefit of all countries in the region.

To conclude, UNECE will, to the extent possible, assist its member States in their integration within the European region and try to ensure that all the countries of the region enjoy full benefits within the international trading system. In order to strengthen economic cooperation with the enlarged EU, there is a need for non-acceding countries to adopt and implement standards and legislation that is not identical to but complies with the *acquis communautaire*. The UNECE is willing and prepared to assist countries in developing these norms, standards and regulatory instruments.



## ***Part II***

# ***TRADE RELATIONS IN A WIDER EUROPE: CHALLENGES AND PROSPECTS***

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## ***Trade between the EU and its Near Neighbours***

“In the context of the Wider Europe Initiative, the Communication offers European citizens and their neighbours the tools for better cooperation, neighbourliness and security along the external borders of the Union. The new approach gives responsibility for cooperation on the external borders to those who are most concerned: the people living in the border areas.”

*(Mr. Chris Patten, the EU Commissioner for External Relations)*

### ***Mr. Hiddo Houben***

*Deputy Head, Trade Analysis Unit, Trade Directorate-General,  
European Commission*

The European Commission in March 2003 published the document “Wider Europe – Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours”, where it has identified a number of countries, a so-called “ring of friends”, with whom it will extend cooperation immediately after enlargement takes place. These are the southern Mediterranean countries, the Russian Federation and western Newly Independent States (Ukraine, Belarus, Republic of Moldova). The initiative does not apply to countries that have a project in place for future EU membership.

The importance of the EU neighbours is considerable. Compared with the enlarged EU, which will have over 450 million inhabitants, these countries have a combined population of 385 million. Most of them, however, have a nominal GDP per capita of less than EUR 2,000, which is less than 10 per cent of the EU average. The total share of world foreign direct investment (FDI), which goes to the new neighbours, is just 1.65% as opposed to the 21.3% that goes to the EU, and acceding and candidate countries.

The EU has free trade agreements (FTAs) in place with most of the countries of the southern Mediterranean. However, these countries do not enjoy FTAs with one another and there is therefore a need for a more coherent approach in the future in order to develop preferential trade and close economic relations among themselves. Because there are no FTAs among the Mediterranean countries, the trading environment is still of a “hub and spoke” nature for this region. It is for this reason that the Barcelona Process aims at the creation by 2010 of FTAs encompassing all the Mediterranean countries concerned, together with the enlarged EU.

### **Barcelona process**

The Euro-Mediterranean Partnership, known also as the Barcelona Process, was established at the Conference of Foreign Ministers of the 15 EU Member States and 12 southern and eastern Mediterranean countries, held in Barcelona on 27-28 November 1995, by signing the Barcelona Declaration. The 12 Mediterranean countries are Morocco, Algeria, Tunisia, Egypt, Israel, Jordan, the Palestinian Authority, Lebanon, Syria, Turkey, Cyprus and Malta. Libya currently has observer status at certain meetings.

The aim of this new phase of partnership between the EU and the above-mentioned countries is to enhance intensive bilateral trade relations and regional cooperation and to create a zone of peace, stability and prosperity by removing the threat of political and economic destabilization of the region.



**The key objectives of the Barcelona Declaration are to:**

- Establish a common area of peace, stability and security in the Euro-Mediterranean region based on the rule of law and democracy and respecting human rights and fundamental freedoms
- Create an area of shared prosperity through the progressive establishment of a free-trade area and the implementation of appropriate economic cooperation and concerted action in the relevant areas and increased EU's financial assistance to its partners
- Develop human resources to promote understanding between cultures and exchanges between civil societies aimed at establishment of partnership in social, cultural and human affairs.

Unlike contractual relations with the EU's other neighbouring countries, the Partnership and Cooperation Agreements (PCAs) in force with the Russian Federation, Ukraine and the Republic of Moldova grant neither preferential treatment for trade, nor a timetable for regulatory approximation. However, these agreements give the prospect of both. Integration should contain a liberalization element; and FTAs should therefore be launched between the EU and those countries in the future.

The importance of bilateral negotiations between the EU and the Russian Federation in creating a Common European Economic Space as well as ongoing negotiations on accession of the Russian Federation to the WTO is indispensable. The Russian Federation plays an important role in the region. Ukraine and the Republic of Moldova may well follow a similar path to the Russian Federation, but there is a need for better integrating them into the European family. Belarus is seen as a special case at present, but is still felt to be a country that should be

given new hope and the prospect of being included in an enlarged Europe in the future.

A new approach for the new neighbouring countries, based on the following incentives:

- extension of the internal market and regulatory structures
- preferential trading relations and market opening
- prospects for lawful migration and movement of persons
- intensifies cooperation to prevent and combat common security threats
- greater EU involvement in conflict prevention and crisis management
- integration into transport, energy and telecommunications networks and the European research area
- new instruments for investment for investment and protection
- support for integration into the global trading system
- enhanced assistance

Giving the example of the well-functioning European Economic Area, established between the EU and some of the EFTA countries, a wider Europe could work on a similar basis. While implementation will begin earlier, the first results of the EU's new neighbourhood policy are expected in 2013.

*(excerpted from the presentation of Mr. Gilbert Dubois, Head of Unit, OSCE and Council of Europe, External Relations Directorate-General, European Commission, speaking on EU near neighbours initiative at the Workshop, UNECE, 2003)*

## ***Regulatory Convergence in a Wider Europe***

***Mr. Constantin A. Stephanou***

*Jean Monnet Professor of European Institutions at the Department of International and European Studies of Panteion University, Athens*

Regulatory convergence describes a process whereby national lawmakers adopt more or less similar regulations in order to respond to the challenges of a changing economic and social environment. There are various public policy goals and motivations in favour of pursuing regulatory convergence.

Thus, for example, many European countries have spontaneously aligned their securities legislation to that of the US, in order to attract foreign investment. For the same reason, economies in transition strive to adapt the regulatory environment to the needs of modern business by introducing effective market regulation and supervision mechanisms.

Regulatory convergence may be initiated by means of international conventions adopted in the context of international standard-setting organizations, such as WIPO, the ILO, the UNECE etc. States are free to become parties to the aforementioned conventions. Regulatory convergence may also be initiated by less formal institutions, such as the Basle Committee on Banking Supervision. The relevant instruments of “soft law” (recommendations, codes of conduct, model laws etc.) are transposed into domestic law, irrespective of their binding or non-binding character.

In the EU there is a mandatory mechanism for regulatory convergence, known as approximation of laws. It aims at the adoption of harmonized rules by member States, in order to combat distortions in the Single European Market, including practices such as social and environmental dumping.

Deregulation has attracted foreign investment in the former energy and telecom monopolies. On the other hand, minimum regulation is necessary for the proper functioning of the market in general or specific

markets in the service sector, in order to protect the public interest. Where there is a need for minimum regulation, it should meet the requirements of transparency and legal certainty.

Last year's recommendations of the Round Table on Industrial Restructuring in European Transition Economies indicate that "Restructuring of the existing enterprises and the creation of new competitive industries depend in large measure on the regulatory and institutional environment created by Governments....Macroeconomic stabilization, undistorted price and tariff structure, competitive environment neutral to all resident companies, both domestically and foreign owned, sustainable enforcement of property rights, including the rights of minority shareholders and intellectual property rights, transparent rules governing new firm formation, and clear regulations allowing for an orderly market exit (bankruptcies) are the key preconditions of successful restructuring and attracting investment to the restructured enterprises, including the strategic direct investment from abroad"<sup>8</sup>.

In the same publication, Professor Paul Hare points out (p. 5) that "In difficult environments where states are new and weak, the best policies are often simple and as uniform as possible (few or no exceptions to constrain damaging lobbying), since they offer fewer opportunities for corruption and provide a clearer setting for business". Thus, the quality of the regulatory environment plays an important role in attracting or deterring foreign investment.

The OECD Council adopted in 1995 a Recommendation on *Improving the Quality of Government Regulation*.<sup>9</sup> In this recommendation, the OECD calls upon its Member States to follow the following checklist for regulatory impact analysis:

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<sup>8</sup> UNECE (2002), *Industrial Restructuring in European Transition Economies. Experience to Date and Prospects*, U.N. Sales No. E.02.II.E.11, at pp. 33-34.

<sup>9</sup> See also, OECD (1997), *Regulatory Impact Analysis: Best Practices in OECD Countries* and OECD (1997), *Regulatory Quality and Public Sector Reform*.

- Is the problem correctly defined?
- Is government action justified?
- Is regulation the best form of government action?
- Is there a legal basis for regulation?
- What is the appropriate level (or levels) of government for this action?
- Do the benefits of regulation justify the costs?
- Is the distribution of effects across society transparent?
- Is the regulation clear, consistent, comprehensible and accessible to users?
- Have all interested parties had the opportunity to present their views?
- How will compliance be achieved?

Some of the mentioned principles are embodied in the well-known concept of the Rule of Law. An important facet of this concept is the principle of legality - i.e. the requirement of a legal basis for government regulation. Other principles embodied in the concept of the Rule of Law are those of equality, proportionality, protection of legitimate expectations, legal certainty, non-retroactivity of taxation etc. Moreover, in enacting legislation, federal States and the EU as such have to observe the principle of subsidiarity.

There has been substantial academic literature regarding States behaving as “free riders”, i.e. staying out of international regimes and/or maintaining low levels of social protection or taxation in order to attract foreign direct investment. In some States in the UNECE region there is a continuing discussion on the merits of acceding to the basic international trade regime, namely the WTO. On the other hand, labour cost differentials between countries acceding to the EU and non-acceding countries are bound to grow as a result of the adoption by the former of EU labour standards. Finally, although taxation levels appear

to play a role in attracting or deterring foreign investment, there is no evidence that any UNECE country has embarked in “race to the bottom” practices. The OECD has issued a report and recommendations on *Harmful tax competition* (OECD 1998). To be sure, there is a strong case for allowing developing countries and Economies in transition to use tax incentives in order to attract investment in key economic sectors. An effective means for attracting foreign direct investment may still be, however, the functioning of a stable and transparent fiscal system.

Accession to international economic organizations entails abandoning some of the aforementioned policy options. Countries aiming to become members of such organizations and in particular the WTO have to adjust not only their foreign trade legislation but also rules on trade in goods, services and intellectual property regimes in order to conform respectively to the GATT, GATS and TRIPS agreements. These agreements lay down relative standards of treatment of foreign goods, persons and intellectual property rights, the most prominent of which is the national treatment clause. But they also lay down absolute and minimum standards of treatment, i.e. substantive rules, in areas such as those of dumping practices, State aids, State enterprises (GATT), technical barriers to trade, sanitary and phytosanitary measures, and government procurement.

Newly acceding countries, including economies in transition, are required to comply with WTO rules upon accession or within a very short period of time. As observed by the former Hungarian Ambassador to the WTO Peter Naray<sup>10</sup>, their political, social, institutional problems are routinely disregarded. “Systemic inconsistencies” with multilateral rules and obligations as was the case with some Eastern European countries when they joined GATT in the 1960’s and 70’s cannot be sustained. Because of the great outside pressure to undertake liberal commitments and the substantial interest of acceding countries in WTO accession, they accept the accession conditions even if they are not sure

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<sup>10</sup> See UNCTAD (2001), *WTO Accessions and Development Policies*, U.N. Sales No. E.02.II.D.19, pp. 148-150.

of being able to implement them fully. Therefore, there is a danger that the present accession policy will produce members, which are WTO compatible only on paper. Naray points out that acceding countries should not be requested to accept more commitments than they can fulfil. Not “liberalization” but “sustainable liberalization” should be the objective. Transition periods should be granted should they be required in a specific accession case. Moreover, an analysis covering the challenges to be expected during the implementation phase including the impact of accession on development should be prepared by an organization other than the WTO. In our view, the UNECE could be entrusted with this task in the case of economies in transition aspiring to become members of the WTO, if adequate resources could be made available.

Special difficulties arise in relation to the commitments regarding State-trading enterprises. As pointed out by Ognitsev / Jounela / Tang<sup>11</sup>, under Article XVII of GATT the criterion is not ownership but rather how and under what conditions the enterprise operates. Thus, privatizing an enterprise, transforming it into a joint stock company or having it operate within special funds does not change its position as a State trading enterprise if it still enjoys exclusive or special rights or statutory or constitutional powers through which, with its purchases or sales, it influences the level of imports or exports. State-owned enterprises, which do not enjoy special rights or privileges, do not fall within the disciplines of Article XVII. Moreover, WTO members have paid special attention to all kinds of monopolies that the acceding countries may have in the areas of production, distribution and/or foreign trade, relating these questions often to State-trading but also to government procurement. Commitments are included in a country’s accession protocol.

Interestingly, even countries which are not members of WTO and are not acceding to the EU have undertaken international obligations aimed

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<sup>11</sup> See UNCTAD (2001), *WTO Accessions and Development Policies*, U.N. Sales No. E.02.II.D.19, pp. 201-202.

at regulatory convergence. Thus, article 53 of the Partnership and Cooperation Agreement between the EC and Russia lays down rules regarding competition law, including State aids, State monopolies and State enterprises; article 54 confirms the commitments under the international conventions for the protection of intellectual property and, finally, under article 55, Russia undertakes to progressively ensure the compatibility of its legislation to that of the EU, in practically all the areas where the EU has enacted legislation.

In the EU, the basic reason behind regulatory convergence in the form of approximation of national legislations is the need to avoid regulatory competition among member States and ensure a level playing field for business<sup>12</sup>. That having been said, social and environmental policy are also related to the improvement of living conditions. In some areas regulatory convergence is left to market forces and in others there are enabling provisions in the EC Treaty for ensuring the approximation of national legislation. The most frequently applied enabling provision is article 95 of the EU Treaty (former article 100 of the EEC Treaty), on which a few hundred directives related to the establishment of the Single European Market have been based. In some other areas where there are enabling provisions, there is often disagreement between Member States about the need to proceed with approximation of national legislations or to allow for market-driven regulatory convergence. The classic example is that of social policy, where disagreements are often related to the application of the principle of subsidiarity. In some EU policy areas where decisions are taken by unanimity, exemptions and opt-outs have been granted to countries which opposed the relevant provisions. The British opting-out from social policy from 1993 to 1999 was perceived by EU partners as a form of social dumping. In the area of fiscal policy, some economists appear to be in favour of market-driven convergence, while others worry about a possible “race to the bottom”. Fiscal policy is an area where unanimity is required under the EC Treaty for the adoption of directives. There is, furthermore, opposition to the granting of exemptions or opt-outs,

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<sup>12</sup> See F. Scharpf, *Governing in Europe*, Oxford, 1998, pp. 84, seq. 109.



because it is felt that countries exempted from harmonization would very soon attract the funds of non-residents. Some Member States insisted, moreover, that non-EU States, including Switzerland, should also be bound by means of a bilateral agreement. The issue appears to be under negotiations.

In conclusion, regulatory convergence is, in some areas, a spontaneous phenomenon and, in other areas, it is related to participation in international or supranational organizations. Regional organizations and, indeed, the UNECE, have played an important role in standard-setting. They should also provide expertise in the form of regulatory impact analysis to economies in transition.

Agreement on Partnership and Cooperation between the European Communities and their Member States and the Russian Federation

Title VI: Competition, Intellectual, Industrial and Commercial Property Protection, Legislative Cooperation,

ARTICLE 53

Competition

1. The Parties agree to work to remedy or remove through the application of their competition laws or otherwise, restrictions on competition by enterprises or caused by State intervention insofar as they may affect trade between the Community and Russia.
2. In order to attain the objectives mentioned in paragraph 1:
  - 2.1. The Parties shall ensure that they have and enforce laws addressing restrictions on competition by enterprises within their jurisdiction.
  - 2.2. The Parties shall refrain from granting export aids favouring certain undertakings or the production of products other than primary products. The Parties also

declare their readiness, as from the third year from the date of entry into force of this Agreement, to establish for other aids, which distort or threaten to distort competition insofar as they affect trade between the Community and Russia, strict disciplines, including the outright prohibition of certain aids. These categories of aids and the disciplines applicable to each shall be defined jointly within a period of three years after entry into force of this Agreement.

Upon request by one Party, the other Party shall provide information on its aid schemes or in particular individual cases of State aid.

- 2.3. During a transitional period expiring five years after the entry into force of the Agreement, Russia may take measures inconsistent with paragraph 2.2, second sentence, provided that these measures are introduced and applied in the circumstances referred to in Annex 9.
- 2.4. In the case of State monopolies of a commercial character, the Parties declare their readiness, as from the third year from the date of entry into force of this Agreement, to ensure that there is no discrimination between nationals and companies of the Parties regarding the conditions under which goods are procured or marketed.

In the case of public undertakings or undertakings to which Member States or Russia grant exclusive rights, the Parties declare their readiness, as from the third year from the date of entry into force of this Agreement, to ensure that there is neither enacted nor maintained any measure distorting trade between the Community and Russia to an extent contrary to the Parties' respective interests. This provision shall not obstruct the performance, in law or fact, of the particular tasks assigned to such undertakings.

- 2.5. The period defined in paragraphs 2.2 and 2.4 may be extended by agreement of the Parties.
3. Consultations may take place within the Cooperation Committee at the request of the Community or Russia on the restrictions or distortions of competition referred to in paragraphs 1 and 2 and on the enforcement of their competition rules, subject to limitations imposed by laws regarding disclosure of information, confidentiality and business secrecy. Consultations may also comprise questions on the interpretation of paragraphs 1 and 2.
4. The Party with experience in applying competition rules shall give full consideration to providing the other Party, upon request and within available resources, technical assistance for the development and implementation of competition rules.
5. The above provisions in no way affect a Party's rights to apply adequate measures, notably those referred to in Article 18, in order to address distortions of trade.



## *Part III*

# *BUSINESS, INVESTMENT AND OTHER RELATED ISSUES IN A WIDER EUROPE*

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## *The Investment Impact of EU Enlargement on the Non-acceding Countries*

*Mr. David A. Dyker*

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What will be the impact of EU enlargement on the non-acceding countries? This is an inherently difficult question to answer. The impact of enlargement on those countries will depend crucially on the investment dimension. Indeed quantitative studies suggest that it is only when we bring investment into the picture that we start to obtain serious numbers for the impact of enlargement on the acceding countries. *A priori* reasoning would suggest that the same pattern would hold for the non-acceding countries – with the added complication that in this case the investment factor could be positive or negative.

Right from the beginning of the transformation process, the great bulk of foreign investment going to transition countries has gone to the Central and Eastern European countries, which has no doubt reflected in part an anticipation of EU accession. It has also reflected judgements about the political stability and the quality of the business environment in the non-acceding countries. The EU enlargement will not affect those latter judgements. While it is true that accession to the EU might create

a “crowding-out” effect, rising income in the newly acceding countries might also create new short-term comparative advantages as well as export opportunities for non-acceding countries. But in the longer term, however, it might turn into something of a poverty trap, with the non-acceding countries finding themselves unable to move up the trade/technology ladder.

That last outcome is not inevitable, but it becomes more plausible when we bring the dimension of industrial network-building into the picture. Historically, medium-sized, engineering-based firms in the advanced industrial countries have developed by moving up the supply hierarchies of key industries like the automotive and electronics industries. This pattern has already been successfully imported into acceding countries. Elsewhere in the transition region, it is conspicuous by its absence. And this is one of the main reasons why there has been so little FDI in the engineering-based industries of, for example, the countries of the former Soviet Union. The EU enlargement is bound to make supply networking easier in acceding countries, because it will ensure that supply chains cannot be disrupted by border formalities. Here, the gap between acceding and non-acceding countries seems bound to increase, and this will make it more difficult for firms coming from non-acceding countries to upgrade their capabilities through industrial cooperation.

Although accession of new EU member countries to EMU is a medium-to-long-term prospect, it is perhaps in order to say a few words about it. To the extent that EMU cuts interest rates, it is bound to reinforce any crowding-out effect *vis-à-vis* the non-acceding countries. But it may by the same token drive risk-loving investors out of acceding countries, possibly towards the countries of the CIS countries and the South-West Balkans. Thus EMU enlargement could, paradoxically, increase investment flows to the non-acceding countries. Whether it would increase investment in the key sectors from a development point of view is another question.

The EU enlargement should not cause a dramatic fall in the amount of FDI going to non-acceding countries. The danger is rather that it will affect the structure of investment, reinforcing the sectoral imbalances

that are already present, and tightening rather than loosening the constraints on future growth and development of those countries.

The EU enlargement will bring some opportunities and challenges for eastern European insurance markets followed by structural changes. The reason why is that the acceding countries were obliged to adopt particular parts of the *acquis communautaire* and to remove particular barriers to trade in this important services sector in order to integrate themselves into the Internal Market. Competition in this sector will increase as market entry barriers come down. Foreign insurers will gain a market share, assisted by the EU directives on solvency rules, which will come into effect in 2004. Consolidation in non-life insurance will continue, whereas in life insurance the trend will be towards setting up branch offices following accession to the EU. This divergence stems from the two sectors' different market environments. In non-life insurance, take-overs are a means of acquiring large portfolios and a relatively strong market position. Life insurance, however, is still underdeveloped and the advantages of acquiring a portfolio are limited. In general, EU enlargement will therefore cause changes in the regulatory framework, which will affect the competitive environment.

*(excerpted from the presentation of Ms. Patricia Baur, Economist, Swiss Reinsurance Company, Zürich)*

## ***EU Enlargement: A Challenge for Small and Medium-sized Enterprises?***

***Mr. Paul Dembinski***

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Does Wider Europe improve the prospects for SMEs? SMEs are an extremely heterogeneous population regarding various aspects, such as size, ownership structure, goals and visions, level of technology, share of exports/imports and the subjective “business distance” to abroad. There are some weaknesses and strengths of independent SMEs regarding enlargement. There are four basic weaknesses:

- lack of strategies, shorter perspectives and smaller means than large enterprises;
- transaction costs are higher for them in relative terms;
- reliance on ad hoc human resources and niches more than “markets”; and
- possible “aggression” on home and natural markets.

On the other hand SMEs adapt better to alternative strategies (reliance on networks and private structures of trust – role of immigrants). Small enterprises are usually opportunity pickers. They are not the prime investors but often they are established by FDI. They are able to switch strategies with qualified human resources and they are flexible compared with large enterprises. Capacity to alternate strategies is very important for the small enterprises. Another positive feature of small enterprises is adaptability to new ventures matching the knowledge of both sides of Europe, so called “bridge enterprises”. Bridge enterprises are based on people having knowledge of two to three institutional, business and cultural environments. They are playing an important role in bringing people together and in understanding a business



environment. Therefore, these enterprises are a significant tool in the integration of the European market.

Nevertheless, large enterprises through their small subsidiaries and affiliates are and have been forerunners of transition, globalization and probably will be the forerunners of integration and in this respect, enlargement can be seen as the opportunity for SMEs.

The EU enlargement would be an opportunity for the further development of SMEs, especially if support can be given to their efforts to penetrate the new EU markets. Human resource development and assistance in the areas of information technology, Internet and e-commerce, should be priority areas. There is a need for better targeted training programmes with new knowledge components, such as knowledge of business operations in the EU, knowledge of the EU market, negotiation skills or quality requirements, in order to help SMEs operate successfully in business within the EU market.

*(excerpted from the presentation of Mr. Claude Cellich, Vice President, International University in Geneva and former Chief of Human Resource Development, International Trade Centre (ITC))*

## ***The Enlarged EU and the Non-Acceding Countries: The Need for Technical Regulation and Standards in Globalization***

***Mr. Nuno Encarnação***

*Expert, Moderator of the UNECE WP.6 Telecom Initiative, Federal Office for Communications, Chairman of ETSI Access and Terminals, European Telecommunications Standards Institute*

There is an urgent need to lower trade transaction costs for the new neighbours. This will require greater transparency and simplified procedures and, especially, harmonization. The convergence towards regional norms and standards is essential for lowering transaction costs and is thus of key importance in the enlargement process.

Tourism, migrations, global media and Telecom benefit from technological developments and determine interpenetration of cultures and habitudes. Some risks, however, are associated with this. Careful but rapid action is required to use the globalization benefits and satisfy peoples' needs and prevent more burdens for appropriate and harmonious human development.

Technical non-tariff barriers to trade were identified by the WTO as a major impairment for the harmonious co-existence and development of countries. Regional organizations are creating wide markets and implementing these principles. Increasingly, regions are creating successful internal markets and developing areas of mutual understanding. Intensive exchange of products facilitates the peaceful exchange of ideas and promotes convergence on solutions for numerous issues within each region and also among regions. For instance, UNECE produced recommendation L, in order to apply WTO principles and facilitate their pragmatic application to sectors where the partners could easily support this initiative. The telecom sector was the first to

demonstrate interest, and the first steps to implement this recommendation L are being taken.

The “Telecom Initiative” used a pragmatic approach, selecting a specific set of well-known products and is at present trying to identify a large number of countries (where administrations wish to collaborate). It is widely recognized that the telecom sector is one of the most relevant infrastructures in all modern societies. As the development of that sector will have a very positive impact on development, this Telecom Initiative is expected to be very successful.

### **Why technical regulations and how to design them?**

Authorities, in exercising their mandate, identify a number of concerns which have to be specified and integrated in the corresponding legislative structure. These legitimate concerns are often expressed in different ways but their fundamentals are largely common and aim to protect the public interest objectives.

A legal framework should be generic, technology independent & identify unacceptable risks.

In the above-mentioned exercise of identifying the fundamentals of the legitimate authorities’ concerns, in order to create transparent principles for regulation, it is important to try to be as generic and independent from specific solutions as possible. This will reduce the risks of pressure from particular lobbies associated with some technologies and force experts in regulatory organizations to focus on the essentials of the public interest.

The message in a legal framework has to be easy to be understood by a wide population and therefore the legal framework has to focus on a limited number of aspects. It is a fact that complex texts confuse some readers and are often the source of diverging interpretations. A simple message with unambiguous interpretation is the optimal way to communicate some fundamental decision that must be respected. In the Telecom Initiative (and some other sectors) these unacceptable risks are associated with, e.g., safety and health risks for users and with co-existence with other products like Electro-Magnetic Interference

aspects. These risks have to be communicated. Technical regulations implementing legal framework(s), should be short, specific, clear and easy to verify and should impose the strictly minimal set of necessary, justifiable and legitimate rules. After having a clear legal framework, the technical regulation “makes the bridge” to objective tools, so that the principles established by the legal framework can be transposed for each of the sectors covered. This transposition should be based on technical regulations. Each technical regulation should be specific (clear scope, what are the items covered and not covered, under which conditions applies, etc... and do not treat risks beyond their scope), clear (simple statements, no requirement should have two interpretations) and easy to verify (the statement of compliance should be unambiguous). The rules imposed have to be justified by the legitimate authorities’ concerns and by the text of the legal framework. They clearly fall within the scope of the technical regulation and they have to be necessary. The technical requirements associated with these rules, to be well understood should be selected or derived from well-accepted standards.

### **Why standards? How to design them? What is their relationship with a technical regulation?**

Standards are technical descriptions of items (products, features or services). Technology dependent products are becoming extremely complex. Without clear and objective (physical, normally geographical and political independent) descriptions using appropriate technical terms and methods of qualification and quantification, it is hardly possible to bring products onto a wide market. Also the complexity of the products requires different partners to contribute to the whole performance of complex systems. Under such circumstances standards become central tools for market participants. This is particularly true for the Telecom sector. With the liberalization evolution and convergence among different groups of technologies (radio and wire lines, broadcasting and telecommunications, etc), there is also an increasing number of aspects to be considered in the standardization.

Test and Measurement methods are the central tool for correctly applying standards. We need them in standards to unequivocally evaluate compliance. We need replicable test and measurement

methods. If test and measurement methods are not harmonised, the same requirement may have different meanings or different requirements may mean the same.

Standards specify relevant characteristics of products using objective descriptions. Product specification needs to address the most relevant characteristics of products. Standards may also be for regulatory use, but this is not the only objective. The majority of the standards are to be used among different market partners to serve their need for reaching a wider market base. Standards should be the result of a common initiative and action of industry experts to promote the use of a certain common solutions and to facilitate the inter-operation of the parts of a whole system. Standards cited in a technical regulation specify limits of parameters for a product to access a market.

Regulatory Authorities may in some cases use available standards, or parts thereof, to express some needs identified in the exercise of their activities. Whenever a standard has a regulatory value, it may limit the access to the market for products not complying with that standard. So, standards do not determine by themselves the access to a market, but through a regulative measure, if mandatory in a specific region or country, preclude the access of products not complying with them.

Standards establish references without limiting the user's choice, while technical regulations limit the choice. Two standards may describe two different and incompatible products or solutions. Users may wish to select products fulfilling one or another standard. Regulatory Authorities in one country may use in some cases available standards, or part thereof, to express in a technical regulation some needs identified in the exercise of their activities. Two technical regulations should not contradict each other. The conditions specified in a technical regulation must be respected and a product not respecting the technical regulation is not permitted to circulate in that market. This means that users cannot select products excluded by a technical regulation.

The legal requirements of regulations are related to:

**- Market access**

Technical and administrative aspects are included in regulation. Other aspects such as country of origin or trade aspects usually also dictate conditions for market access and are sometimes included in the administrative aspects.

**- Market surveillance**

Irrespective of the market access rules (“approval”, third party or supplier declaration of conformity or other regimes), there is a need to exist an element of “policing” the market to ensure compliance with the rules by all players. If these rules were reduced to the minimum absolutely necessary, there shall in any case be a deviation from them. The smaller is the set of rules, the more important is to survey them and the more effective this surveillance can be.

To conclude, harmonization of regulatory measures, such as the technical regulations, standards and product specifications, stimulates markets and common understanding between market operators and thus facilitates trade. Therefore, regulatory measures become a central issue for wider Europe.

“Globalization is a fact; we just have to know how to face it. Closer integration across the European continent will help all countries in the region to better manage the impact of globalization”

*(Mr. Nuno Encarnaç o)*

## ***Regional Integration and Governance: How will the Wider Europe be Governed?***

***Ms. Brigid Gavin***

*United Nations University, Comparative Regional Integration Studies (UNU/CRIS), Bruges, Belgium*

The European Union has managed relations with its neighbouring countries by establishing a network of regional trade agreements. As far back as the 1960s the Community initiated association agreements with some Mediterranean countries such as Cyprus, Malta and Turkey. The Europe Agreements were concluded in the early 1990s to achieve enlargement towards the East. As a counterbalance to this expansion, the Union launched the European Mediterranean Partnership in 1995 to foster regional integration with countries in the Middle East and North Africa. In the post-Soviet era the EU has extended its ties to Russia and the Western newly independent States of Ukraine and Moldova through Partnership and Cooperation Agreements (PCAs). Belarus has been excluded so far. In the new geopolitical realities of the post-Soviet era, the map of Europe has been redrawn. A new continental architecture stretching from the Atlantic to the Urals is emerging. The EU, as the cornerstone of that new architecture, should now consolidate its enlargement success by providing a clear strategy for governing the Wider Europe.<sup>13</sup>

The signing of the accession treaty with ten new members in April 2003 is a major foreign policy success for the EU. Fifteen years after the fall of the Berlin wall, the former communist countries have made monumental progress towards rebuilding their nations in the mould of free market economies and pluralist democracies. This is the triumph of

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<sup>13</sup> The European Commission (2003) defines the Wider Europe to include the Southern Mediterranean countries: Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria, Tunisia. On the Eastern front it includes Russia and the Western Newly Independent States (WNIS): Ukraine, Moldova. Belarus.

Europe's 'soft power', which is defined as the power to attract and persuade other countries without relying on military or financial 'hard power' as a means of coercion.<sup>14</sup> The EU has used its soft power effectively in shaping and moulding the new members' policies and institutions over the last ten years in preparing them for enlargement (Grabbe, 2003).

The outer circle of countries on the EU's borders is far behind the new member countries in terms of economic development and State building. The EU has brought those countries into the fold using a carrot and stick approach, which has stabilized their economic performance and increased convergence with existing member States (Barysch, 2003). Table 3.1 shows just how far these countries have come. In stark contrast to this, we see the alarming divergence between the countries of Wider Europe and EU average income levels in table 3.2.

*Table 3.1*

**Economic convergence between the accession countries and EU-15**

<i>Country</i>	<i>Population (millions)</i>	<i>GDP per capita as % of EU average</i>
Cyprus	0.7	85
Czech Republic	10.3	59
Estonia	1.4	37
Hungary	10.1	50
Latvia	2.4	33
Lithuania	3.7	29
Malta	0.4	55
Poland	38.6	39
Slovakia	5.4	48
Slovenia	2.0	69
EU	377	100

*Source:* Barysch (2003). Data from 2000.

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<sup>14</sup> See Joseph Nye (2003), 'Europe is too powerful to be ignored' in *The International Herald Tribune*, 10<sup>th</sup> March. His classic book on the topic is *The Paradox of American Power: Why the World's only Superpower can't go it alone*, which was published in 2001.



*Table 3.2*  
**Economic convergence between the Wider Europe and EU-15**

<i>Country</i>	<i>Population (millions)</i>	<i>GDP per capita as % of EU average</i>
Israel	6.3	79.7
Algeria	30.3	7.8
Egypt	64.0	7.3
Libya	5.3	n.a.
Morocco	28.7	5.6
Tunisia	9.6	9.9
Jordan	5.0	8.3
Lebanon	3.5	19.1
Palestinian Territories	3.0	6.4
Syria	16.6	4.8
Belarus	10.0	5.7
Moldova	4.3	1.8
Russian Federation	145.4	8.3
Ukraine	49.3	3.4

*Source:* European Commission (2003). Data from 2000.

The EU must move quickly if it is to replicate its enlargement success on the wider European level. The European Commission (2003) has taken the first step calling for a “ring of friends” with whom it can develop peaceful relations in matters of economics, security and cooperation. It is a step in the right direction but the policy is still skeletal and much hard work will be needed to flesh it out. Even more important, there is no political locomotive to drive the process as Germany did for enlargement. Germany considered enlargement as a “moral imperative”, as a means of reconciliation with its Eastern neighbours for the suffering inflicted upon them by the Nazi regime. Although other countries were less enthusiastic – notably France – successive German Governments constantly propelled the enlargement process forward. That drive currently does not exist for integration of the Wider Europe. However, the current crisis in European integration over the Iraq conflict has served to concentrate minds. The new European order that is emerging from the ashes of the Second World War could provide the catalyst for major progress.

This presentation will address the key questions of regional integration and governance today and particularly how the wider Europe will be governed, examining the mode of governance used for the eastern enlargement, comparing the role of governance in the effectiveness of integration with the Euro-Med countries, looking at the recent developments in relations with Russia and changes needed for governance of the Wider Europe and its implications for the future of Europe.

## **Governance and enlargement**

Enlargement was a complex dual process involving transition from single party command economies to democratic market based economies, and integration into the EU internal market (Feldman, 2003). The Europe Agreements that were signed between the EU and the accession countries provided the legal basis for integration. They formalised the relationship between the parties and provided the framework for the deepening of integration.<sup>15</sup>

The European Commission played a central role in the “multidimensional” interaction which paved the way for membership. Entry into the EU’s internal market requires ‘deep integration’, which goes beyond traditional trade liberalization to include regulatory and institutional reform. The accession countries were obliged to adopt the “*acquis communautaire*”, which required harmonization of rules in many sectors of economic activity.

European governance is a hybrid construct between supranationalism and intergovernmentalism. The European Commission defines governance as the combination of rules, processes and behaviour of actors that affect policy making at European level, particularly as regards openness, participation, accountability, effectiveness and

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<sup>15</sup> The structure of the Europe Agreements was wide-ranging covering free movement of goods, services, labour and capital, as well as provisions for institutional reform.

coherence.<sup>16</sup> The mode of governance used for enlargement was the well tried “community method” that had successfully served for building the Union’s own internal market. The community method, which distinguishes the EU from other regional integration schemes, puts the European Commission in the driver’s seat. Acting as the executive arm of the EU, the European Commission is the sole initiator of policy who thinks in the general European interest and arbitrates between special interests. It also acts as guardian of the treaty to ensure correct implementation of the rules.

The European Commission prepared the “road map” for accession, which consisted of a multidimensional programme to achieve economic, political and institutional reform. The European Commission also managed the financial assistance that was necessary to help overcome the considerable adjustment costs incurred by these reforms and to provide the necessary technical assistance. By merging the multiple elements and by constant monitoring of the process the European Commission provided an anchor for the transition process, and it ensured credibility and continuity in the reform process. When countries such as Slovakia were tempted by autocracy, the European Commission pulled them back from the brink.

“The Commission put together twelve remarkable teams of negotiators who reached a deal on thirty one chapters with each and every acceding country. Day in, day out, for over three years, 350 Commission officials and over 700 people in the Commission’s delegations in the candidate countries have been weaving the fabric of this silent revolution”

*(President Romano Prodi speaking before the European Parliament, December 2002)*

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<sup>16</sup> This definition is given by the Commission in its White Paper on Governance published in 2001.

The successful completion of the enlargement negotiations, and how things fell into place despite numerous setbacks, was a triumph of the community method and the central role played by the European Commission. The work of the Commission was recognized by the European Round Table (ERT) of industrialists as “a monumental achievement”. However, the ERT warned that a good dream can go wrong and that several issues remained open yet, as for example clear defining of roles and responsibilities of the EU institutions.

The lesson of enlargement is that the EU is now well placed to move closer to the Wider Europe. The Commission needs to take a strong leadership role in engaging those countries in economic integration at the regional and global level.

## **Governance and southern integration**

The mode of governance for southern integration is more intergovernmental where Member States and their Foreign Ministers play the leading role. The organizational structure of the EMP is a complex mixture of elements based on three pillars: multilateral, which governs the political, security and infrastructure projects; bilateral which governs trade; and unilateral, which governs financial and technical assistance.<sup>17</sup> The Ministers of Foreign Affairs are clearly in charge of the process with a less important role assigned to the European Commission than was the case with enlargement. The political driver was France, who has major interests in the MENA region from its historical involvement in a number of countries there.

The MENA countries needed a comprehensive programme of trade liberalization similar to what was implemented in Eastern Europe. The structure of many economies in the Southern Mediterranean region was

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<sup>17</sup> The three organizational dimensions of the Euro-Mediterranean Partnership is illustrated in detail by E. Phillipart (2003), in his comprehensive study: *The Euro-Mediterranean Partnership: Unique Features, First Results and Future Challenges*. See Figure 1, p. 34. The three pillars cover up to 40 sectors with about 50% covered by the economic and financial pillar and 25% respectively for the other two.

rather similar to the Eastern countries in that there was a long tradition of State control and inward-looking trade policies. What they needed was a “deep integration” that would bring about regulatory reform as well as dismantling the high tariff walls. But that has not happened in practice.

The Euro-Med agreements have been much less effective than the Europe Agreements in delivering economic welfare results. The EMAs are weaker and slower than the EAs and they have achieved very limited deep integration. The hortative language of the EMAs has been ineffective in addressing regulatory barriers and there is no mechanism for monitoring the commitments made. They have contributed to a network of bilateral agreements but little progress towards a free trade zone has been made. Furthermore, the negotiations have been fraught with difficulties and some have stalled altogether. The current status of the Euro – Med Agreements is shown in table 3.3.

*Table 3.3*  
**Current Status of Euro – Med Agreements**

<i>Country</i>	<i>Signed</i>	<i>Entry into force</i>	<i>WTO status</i>
Israel	1995	2000	Member
Tunisia	1995	1997	Member
Morocco	1996	2000	Member
Palestinian Territories	1997	1997	Non-member
Jordan	1997	2002	Member
Egypt	2001		Member
Algeria	2002		Non-member
Lebanon	2002		Non-member
Syria*			Non-member

\*An association agreement with Syria is under negotiation.

*Source:* E. Philippart (2003), and T. Beart (2002).

The European Commission was given a limited role to play in the overall economic objective of the EMP, which was to achieve reciprocal free trade by 2010. The European Commission prepares country and regional strategy papers defining long-term objectives and priority areas, national and regional indicative programmes based on the strategy

papers, as well as annual financing plans, including a list of projects to be financed. The Commission has to ensure coherence of overall EU policies and complementarity with Member Countries' assistance to promote co-financing where appropriate.

EU funding under the development assistance programme MEDA has increased from 3,425 million dollars for the period 1995-1999, to 5,350 euros for the period 2000-2006. However, the lion's share of EU development aid has gone to Eastern Europe rather than to the Mediterranean region. The European Union's bilateral ODA is shown in tables 3.4.

*Table 3.4*

**The European Community's Bilateral ODA, 1999-2000**

<i>Top Ten recipients of EU Gross ODA (US Dollars millions)</i>	
Poland	743
Czech Republic	355
Romania	254
Yugoslavia (including Kosovo)	235
Morocco	251
Bosnia and Herzegovina	218
Hungary	208
Slovak Republic	202
States of Ex-Yugoslavia	176
Egypt	144

*Source:* OECD.

The inter-governmental model of governance allows the foreign policy interests of the larger Member States to play an influential role in the whole process. This has led to a slower and weaker form of integration in the South compared with the East. Shallow integration has taken place across some 40 sectors but in practice little has been achieved in regulatory reform that is essential for deep integration. The multidimensional interaction that was so successful in the Eastern integration was lacking in the EMP thereby leading to very limited

progress.<sup>18</sup> The high politics of the Israeli-Palestinian conflict undoubtedly created obstacles. The prospect of integration into the EU's internal market was also missing, thus removing a major incentive for reform. Lessons from enlargement suggest the need for upgrading of the economic pillar to multilateral status and movement towards the community method of speedy and more solid integration.

### **Recent developments on the eastern front**

The great uncertainty about how relations between the EU and Russia, "the elephant and the bear", would develop in the 21<sup>st</sup> century has begun to lighten. Since the election of the Europeanist President Vladimir Putin in 2000, there has been a shift away from military matters to economic negotiations. Regional cooperation has increased and the focus is on energy dialogue, environment cooperation in major issues such as the Kyoto Protocol, and mutual interests in major foreign policy issues and security. Whether Russia will become the privileged partner of the EU in the future is still open.

The EU 'common strategy' of 1999 stated that "The Union and its member States offer to share with Russia their various experiences in building modern political, economic, social and administrative structures, fully recognising that the main responsibility for Russia's future lies with Russia itself". Priority areas of the strategy include consolidation of democracy, the rule of law and public institutions, the integration of Russia into a common European economic and social space, and European stability and security.

Prospects for improving EU-Russia relations seem brighter now than ever before. The Russian economy is recovering from a decade of collapse and mounting debt, which left it dependent on foreign aid from Western sources including the International Monetary Fund (IMF) and the World Bank. President Putin ended borrowing from the IMF after he

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<sup>18</sup> See T. Baert (2003) for a full economic analysis of the ineffectiveness of the Euro-Med agreements in addressing the regulatory barriers to trade, with a case study of the longest standing agreement, which is the EU-Tunisia agreement.

became president. Rising oil prices have given Russia relief and shored up its ailing finances. Russia is the world's second largest producer of oil and rising prices has brought in revenue helping to reduce the national debt. Russia is now able to repay IMF debts ahead of schedule.

Russia has become an attractive country for foreign investors thanks to its economic reforms. In February 2003 British Petroleum announced that it would make the largest ever foreign investment in Russia by taking a 50 per cent share in a new venture that would become the country's third largest oil producer. This deal alone represents about one and a half times the total foreign investment of last year. This is considered as a sign that Russia has become economically stable enough to attract large Western investors. The economic improvement means that Russia is getting foreign investment now and no longer needs foreign aid. The new economic optimism has made Russia more assertive and more pro-European in its foreign policy. By siding with France and Germany in opposition to the US-led war in Iraq, Putin has shown his support and commitment to a 'multipolar' world as the best basis for security.

Russia and the EU have major economic and security interests in common. The EU is Russia's major trading partner but it has a huge trade deficit with Russia because of its dependence on energy supplies. Russia could become a major market for EU exports.

### **Need to revitalise regional agreements**

The EU now needs to move quickly to establish a coherent strategy for the Wider Europe. The Communication from the European Commission in March 2003 is very timely and needs to be worked out more speedily and comprehensively. The European Commission must play the leadership role in trade governance – where it has both competence and expertise to lead at the regional and global level.<sup>19</sup> The need for strong

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<sup>19</sup> The EU is a powerful player in the WTO system of global trade governance. With the size of its market, and the fact that it speaks with one voice, it has created an



economic governance has been compounded by recent security developments.

Convergence between rich and poor countries has taken on a political dimension since the terrorist attacks of September 2001. Terrorism became the greatest threat to European and global security. As it is harboured in poor countries, integrating poor countries into the international economy can act as a more powerful means of conflict prevention than the development of military might. The EU's policy of conflict prevention through aid and trade, which is an unsung song of success, should continue to play a pivotal role in its foreign policy.

The EU needs to kickstart its regional integration in the Southern Mediterranean and to give a new impetus to trade with its Eastern neighbours. Although Russia has a population of 144 million, its share of world trade is less than that of Singapore with a population about 4 million. Regional integration will facilitate the entry of Russia and the other countries into the World Trade Organization. The Wider European countries need to lessen their dependence on exports of primary products and to develop the production of industrial goods and services. The emerging markets of Asia and Latin America have made considerable progress in this direction over the past few decades.

The EU needs to bind those countries into its foreign trade policy along two parallel tracks – the multilateral track and the bilateral track through regional agreements.<sup>20</sup> The old controversy about whether regional trade groups are stumbling blocks or building blocks to global free trade is caught in a time warp. The empirical evidence shows overwhelmingly that regional integration is complementary to global liberalization today. Since the 1990s there has been a new wave of

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effective counterweight to the United States and it has created a 'multipolar' trade world. See Gavin (2001) for an overview of the EU's role in the WTO.

<sup>20</sup> Over the years the EU has developed an extensive network of RTAs by creating a hub and spoke system of connections with other regional groups such as the ACP countries, ASEM, Mercosur in Latin America and ECOWAS in Africa.

regional trade agreements worldwide – the ‘new regionalism’.<sup>21</sup> As the number of RTAs increase in the global economy there are diminishing costs for their members and there are increasing costs for those that are outside. So, regional integration can deliver increasing benefits in economic welfare.

The successful model of enlargement provides the main signposts along the road map for Wider Europe. The EU should offer increased market access to those countries that adopt the appropriate policies to expand their markets. Expanding markets, which is a wider concept than reducing trade barriers is analogous to the multidimensional approach that was very successful in the eastern enlargement. We could call this approach ‘augmented trade governance’, which is based on three pillars of interrelated action relating to economic reform, political reform and a sustainable growth strategy.

Economic reforms include macroeconomic stability to ensure low inflation and low budget deficits and stable exchange rates. This is the foundation of good economic governance. In this context, de facto movement towards the Eurozone will offer long term benefits of stability that outweigh any short term ‘adjustment’ costs. The EU has given no calendar for the ‘passage to the euro’ to the accession countries. But the Maastricht criteria will apply and all accession countries will have to stay at least two years in the new exchange rate mechanism (Pelkmans and Hobza, 2002). The countries of Wider Europe could minimise the risk of a financial crisis or instability by gradually moving their policies towards the Maastricht criteria. Microeconomic reforms include trade liberalization, financial liberalization in proper sequencing, adopting competition policy, and good corporate governance, especially international accounting standards.

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<sup>21</sup> For a multicausal explanation of the growth of these RTAs against a background of globalisation, see Gavin and Van Langenhove (2003); ‘Trade in a World of Regions’.

### **Maastricht criteria**

To ensure achievement of the sustainable convergence required for joining the economic and monetary union (EMU) the Maastricht Treaty sets five convergence criteria, which must be met by each Member State before it can take part in the EMU. Acceding countries must also fulfil those criteria. The criteria are:

- the ratio of government deficit to gross domestic product must not exceed 3%;
- the ratio of government debt to gross domestic product must not exceed 60%;
- there must be a sustainable degree of price stability and an average inflation rate, observed over a period of one year before the examination, which does not exceed by more than one and a half percentage points that of the three best performing Member States in terms of price stability;
- there must be a long-term nominal interest rate which does not exceed by more than two percentage points that of the three best performing Member States in terms of price stability;
- the normal fluctuation margins provided for by the exchange-rate mechanism on the European Monetary system must have been respected without severe tensions for at least the last two years before the examination.

Political reform calls for the development of a vigorous civil society, pluralist democracy and accountability of government, respect for human rights and fundamental freedoms, and the rule of law. A sustainable growth strategy requires appropriate environmental standards, for example water and soil quality, and commitment to global rules in such areas as climate policy.

To summarise, the new trade strategy should offer ‘enriched conditionality’, which aims to create a predictable environment for business and ‘regionalise’ markets thereby increasing attractiveness for foreign investment. The strategy needs to be backed up by significant amounts of trade-associated technical assistance to achieve the necessary reforms and support institution building. This type of regionalism, which is WTO+, will ensure that trade liberalization dominates over trade diversion.

### **The future of Europe – towards a new constitution**

Europe has closed the door on Yalta and the Cold War as the EU integrates former communist countries into its fold and as NATO expands its membership eastwards. A new chapter of European history is opening up so we need to define what the nature of the new Europe will be, and how it will be governed. This is currently being drafted by the European Convention in preparation for the next Intergovernmental Conference set to conclude in December 2003.

“The conclusions of the Convention will help pave the way for our common future. So my message to the members of the Convention is: be visionary and ambitious. But build on present-day realities. Aim high but don’t have heads in the clouds. And don’t get carried away by your own rhetoric, using grandiose words which do not correspond to these realities. In short, the EU of tomorrow must be based on farsighted visions but pursue concrete and realistic goals. After all, this formula has served the Union extremely well in the past. This was how we created the Single Market and the EMU. It was also the guiding principle behind the success of the enlargement process. And I dare say that this is the key to future progress as well.”

*(Anders Fogh Rasmussen, Prime Minister of Denmark, speech delivered at the College of Europe, Natolin, Poland, 28 February 2003)*

The Convention produced a draft Constitutional Treaty for Europe with a Bill of Rights for European citizens consolidating the existing plethora of treaties into one single treaty with a legal personality. It will make the new treaty accessible to European citizens and streamline the decision-making to become more efficient, democratic and transparent. It will lead to a new President of Europe and a European foreign minister who will represent Europe on the global stage. The Convention will set the terms of reference for the next Intergovernmental Conference (IGC), which is expected to set the rules of the game for future European governance. This will be a defining moment for the EU, which currently sits uneasily between enlargement and global irrelevance.

The governance of a Wider Europe will depend much on what kind of institutional framework emerges from the Convention and subsequent IGC. The debate about the institutions goes to the core of the Convention's work. The success of European integration, including its most recent success on enlargement, has been largely the result of the institutional model of the community method, in which the European Commission played a powerful role. There is now growing political momentum to rearrange that institutional framework and move towards a more intergovernmental model. Should that happen the future of Europe might be less integrationist with a return to the 'balance of power' model of the nineteenth century.

## **Conclusions**

The new geopolitical context of Europe in the post-Soviet era and post Iraq war creates urgent pressures for the EU to assume a stronger leadership role in the governance of the Wider Europe. For almost fifty years, Jean Monnet's model of governance provided a clear guiding principle for economic integration. Today, Europe is evolving into a political community based on common values. The old borders between economics, politics, security and human rights have become blurred. The new conceptual approach to regional integration is based on multidimensional interaction, which is a wider notion than economic integration, and which requires simultaneous action on several fronts.

The EU needs to devise a coherent governance structure for the concentric circles of countries that surround its borders. Up to now the EU has successfully navigated its successive rounds of enlargement. The most successful mechanisms for achieving integration have been the concrete targets and timetables that the European Commission has set for the new countries. Firm commitments have provided an anchor and appropriate incentives for the new Member States to achieve the standards necessary for participation in the internal market.

The EU should continue to use the fundamentals of this method for governing the wider Europe. This implies that the central role of the European Commission should not be compromised and it must continue as the independent arbitrator of the European interest in all key sectors of the economy. This central role should be incorporated in the new Constitution, which is currently being drawn up to chart the future institutional architecture of Europe

There is a window of opportunity now open for the EU and the Member States to exploit. *Eurobarometer* surveys conducted by the European Commission show that European public opinion is ahead of the political process in wanting the EU to play a stronger leadership role both at home and abroad. Therefore, the time is ripe for the EU to go for it and to create an effective and democratic structure for governing the Wider Europe.

## ***The Social and Economic Dimension of EU Enlargement***

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### **Overview of the economic performance in the CEEC**

The social and economic transformation of the Central and Eastern European countries (CEECs) started right after the fall of the iron curtain in 1989 and was also very much linked with the prospect of accession of these countries to the EU. The actual date of membership was not as decisive in this matter, as the transformation processes targeting EU integration. When the attention is focused on the cost side of the process, there are the factors which have placed the most severe constraints on the transformation and resulted in some burdens on society. These can be summarized as changes in the “external environment”.

The most important external factor was the collapse of COMECON. This was only the final act in a process that was already under way – the reorientation of trade from the East to the West. Consequently, the conditions for the respective economies were very unfavourable. This situation marked an abrupt and dramatic change in the position of these countries in the world economy. From having been a relatively developed periphery of an under-developed centre (the Soviet Union), they suddenly came into the position of an under-developed periphery of a developed centre (the European Union). The former share of labour meant that CEECs were suppliers of technology and machinery to the Soviet Union in exchange for energy and raw materials, whereas the latter meant exporting low-tech, labour-intensive mass products to Western Europe and importing technology and machinery. This compelled the restructuring of national economies in their entirety within a very short period.

The second element of the unfavourable external conditions is the high entry costs for newcomers to the world market. Even under free market conditions, the entry costs for newcomers to an already established market are high enough. Two factors should be mentioned here: most market segments are dominated by powerful multinational companies and brand names introduced decades before. Even if newcomers were able to meet the quality standards, they have only vague chances of breaking into the market. The second barrier is the high capital needs of market entry, which is a particular problem for aspiring entrants. Moreover, “free market conditions” in the trade with the West were a “one way street” in the most critical initial period, as the sensitive segments of Western markets were effectively protected while the internal markets of Eastern countries were quickly liberalized. The greatest beneficiary of this process was Western Europe.

Structural change and the transformation of the economy needed capital, which in these countries, was scarce. On the contrary, most CEECs (for example, Hungary and Poland) were already heavily indebted before the changes and had to service their debt towards their creditors. This resulted in an East-West capital flow instead of one in the opposite direction. This was characteristic especially of the first couple of years; later, FDI became greater than the level of debt servicing.

Summing up the above, CEE countries faced an enormous challenge of structural change and transformation, for which they would have needed substantial capital. This was not forthcoming, as a result of which they started the transformation with a large “modernization deficit”, what means the potential capital requirements of the transformation and EU accession, for which there was no source in the respective countries.

Structural change was financed in two ways: on the one hand through FDI and privatization (in cases where State property was sold to foreigners); on the other hand, by the regrouping of internal resources for development purposes, from the social sphere and from population consumption. The modernization deficit was converted into a social deficit in the course of the ten years of transformation. This is what we face, in Poland and Hungary, which were considered the most successful transformation countries. They have managed to transform



their economies in ten years, as a result of which they are now well-running market economies with the share of the private sector around 80%, the share of foreign capital in producing GDP at 25-50%, over 80% of trade being conducted with EU countries, a 5-10% yearly growth in productivity and 5-6% yearly growth in GDP. Nevertheless, this process was also accompanied by some unfavourable changes, such as a dramatic drop in employment, a polarised society, continuing low wages, fewer employee rights and less workplace safety and a crisis in both the health care and the public education system.

By now, the Central and Eastern European region belongs to the most dynamic regions of the world, with an average growth prospect of around 3% for 2003. The source of the growth is increasingly domestic consumption, as exports are declining due to the stagnation of the world economy with special regard to the poor performance of Germany. By the year 2000, only four countries managed to surpass their 1990 GDP level. Poland took the lead with 44% growth, followed by Slovenia with almost 22%. Slovakia and Hungary showed a GDP growth of 10%, while the Czech Republic just reached the GDP level of 1990. Latvia had the poorest record with just 60% of its GDP level a decade earlier. Lithuania, Bulgaria and Romania still had a way to go in reaching their 1990-level GDP (table 3.5).

*Table 3.5*  
**Level of GDP in real terms in 2000,  
compared to the level of 1990 (=100,0)**

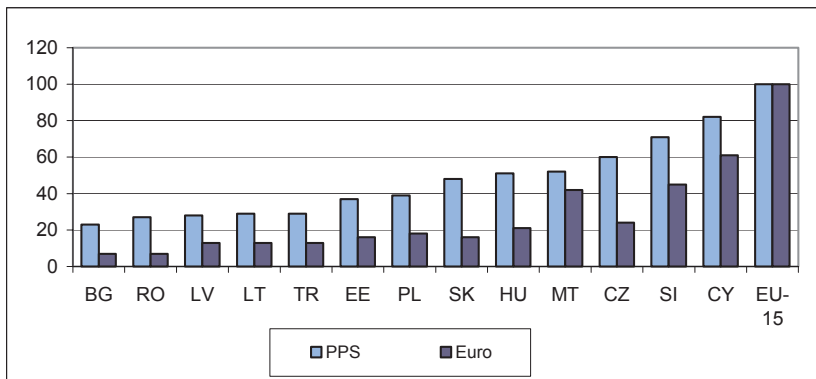
Czech Republic	100.3
Slovakia	109.1
Hungary	109.7
Poland	144.0
Slovenia	121.6
Romania	84.4
Bulgaria	80.1
Estonia	97.5
Latvia	62.0
Lithuania	70.1

*Source:* WIIW database 2001, European Training Foundation 1999, own calculations.

The GDP development of candidate countries has certain features in common. Each country has suffered a dramatic fall of GDP in the first two to three years of transformation. Differences were great in the pace and endurance of the recovery. It is quite natural that each country has lived periods of structural change and stabilization, when GDP growth was moderate or even negative. It is a decisive factor, however, if countries have managed to enter a phase of sustainable development by the end of the period.

Graph 3.1 shows the GDP per capita level of candidate countries in relation to EU average for the year 2000 (data for EU members is based on the year 1999). The difference between the GDP per capita of CEE candidate countries compared to the EU average shows an enormous gap, if we use exchange rate parities. In this case the differences between individual CEE countries are also great. If we regard data at purchasing power parities, the gap appears much smaller, although individual countries still range between 20 and 70% of the EU average. The difference between the GDP per capita of CEE candidate countries compared with the EU average shows an enormous gap, if we use exchange rate parities.

*Graph 3.1*  
**GDP per capita in levels, Current euro vs. PPS**



Massive structural change of the last decade has led to a structure of manufacturing industry in most candidate countries that is quite close to European patterns with the exception of Bulgaria, Romania and the

Baltic States. Productivity growth was substantial in candidate countries, especially from the second half of the nineties. Hungary is the productivity leader among Eastern European candidate countries, slightly surpassing the 50% of the EU average. On the other hand Bulgarian and Romanian labour productivity is just around one fourth of the Hungarian level. According to a study of WIIW on industrial competitiveness of candidate countries, their exports are generally still more specialized on labour intensive industries than in EU Member States. However, the Czech Republic, Slovakia, Slovenia and especially Hungary focus less on labour intensive industries in their exports to the EU than do Greece and Portugal. Hungary's representation of labour intensive exports to the EU is comparable to that of Austria, Denmark and Italy. As regards the representation of technology-driven exports to the EU, Hungary has the greatest share among candidate countries (similar to that of the United Kingdom and Ireland), followed by Slovakia, the Czech Republic and Estonia, while Bulgaria, Romania, Latvia and Lithuania have the lowest share.

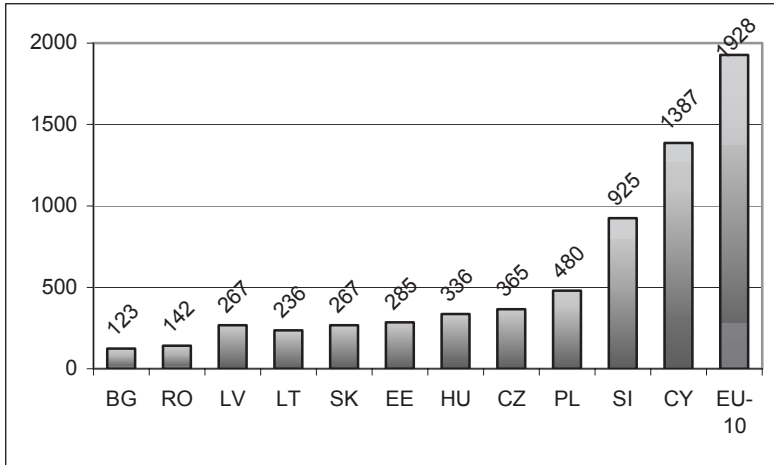
### **Wage levels of candidate countries compared to EU member States**

Monthly average gross nominal wages in the total economy throughout candidate countries range from 123 Euro in Bulgaria and Romania to 480 Euro in Poland, if we exclude two countries with much higher wage levels: 925 Euro in Slovenia (data 2000) and 1387 Euro in Cyprus (data 1999). Monthly average gross nominal wage throughout the European Union ranges from 606 Euro in Portugal to 2,997 Euro in Denmark (data 1998).

Graph 3.2 shows the levels of average gross wages in candidate countries. For comparison, the average for ten selected EU countries is given here as well. (Note: EU-10 covers Denmark, Germany, Spain, France, Ireland, Netherlands, Austria, Portugal, Finland, United Kingdom in 1998.)

For example, whereas the EU average wage stands at 1,928 Euro monthly, candidate countries (without Cyprus) have an average of 345 Euro. It must be added that year-to-year changes in individual countries

*Graph 3.2*  
**Average monthly gross wages in candidate countries in 2000 (Euro)**



*Source:* Eurostat, Statistical Yearbook on candidate countries, WIIW, 2001; and Earnings in industry and services in the EU, 2000.

can be substantial depending on exchange rate changes. In any case, nominal figures seem to be rather shocking, although wage levels at purchasing power parity show a somewhat less dramatic view.

Taking the average of wages at Purchasing Power Parity (PPP) in the 10 Eastern European candidate countries, we get 815 Euro, which compared to the 2,086 Euro for the 10 EU countries gives a rate of 39%, which accounts for a more balanced distribution. The lowest value within the mentioned ten EU countries is 933 Euro, represented by Portugal (exceeded by three CEE countries), while the highest one (2,623 Euro) by the United Kingdom. This indicates that the gap in living conditions is not that great, as seen from nominal data and shows that the danger of social dumping is not as threatening, as one would think from first sight. It is also interesting to see that the distribution among candidate countries also shows a substantial shift, as differences seem also less dramatic within this group.

## **Some conclusions with a view to the benefits and costs of transformation**

If we accept the principle (ETUC CB guideline) that wages in a given country should at least grow at the pace of GDP growth and should possibly grow close to the growth rate of productivity, then most candidate countries fall short of these criteria (taking the processes of the 10-year observation period into account).

The development of real wages in the period from 1992 to 2000 was lagging substantially behind labour productivity developments and in most countries also behind GDP growth. This fact points among other things to the very low efficiency of social dialogue and to the weak positions of labour interest representation bodies in most candidate countries.

The actual situation on the labour markets of the candidate countries differs widely, reflecting structural differences as well as recent economic development. In almost half of the countries, unemployment rates are significantly above the EU average. The macroeconomic scenarios foresee only very gradually falling unemployment rates over the next few years, and even an increase in the case of Poland.

Only Hungary, Slovenia and, perhaps surprisingly, Romania show low and stable unemployment figures under the EU average (8.2% in the year 2000). The still favourable unemployment rates of the Czech Republic show a continuous deterioration. The rest of the countries, including Bulgaria, Poland, Slovakia and the three Baltic States have high and persistent unemployment around or above 15%. It is also cause for concern that this latter group of countries shows an increasing trend of unemployment.

Poverty is still growing. Taking the example of Hungary, which otherwise showed a sound development during the transformation process, official statistics show that the number of people living under the officially calculated (on the basis of a socially still acceptable shopping basket) minimum existence came to one tenth of the population in 1968. On the basis of ILO conformity calculations this share of the population was 8% in 1989, which doubled until 1992, than

rose to 20% in 1994 and did not change significantly since then, although the economy showed substantial growth year by year (table 3.6). In other CEECs, where economic growth is not sustainable, one can find up to 40% of the population at the poverty level. In countries such as Bulgaria, Romania and Latvia, poverty is still a mass phenomenon. Poverty in absolute terms (incomes compared to subsistence minimum) is rather high, as we see, but poverty in relative terms is even higher. This we can see when we compare the average incomes of different social strata to the national average income. If the ratio is under 50% of the national average, we regard the person as poor.

*Table 3.6*  
**Unemployment rate (ILO methodology) as % of labour force**

	1996	1997	1998	1999	2000
Bulgaria	13.7	15.0	16.0	17.0	16.4
Czech Republic	3.9	4.8	6.5	6.7	8.8
Hungary	9.9	8.7	7.8	7.0	6.4
Poland	12.3	11.2	10.6	13.9	16.1
Romania	6.7	6.0	6.3	6.8	7.1
Slovakia	11.3	11.6	12.5	16.2	18.6
Slovenia	7.3	7.4	7.9	7.6	7.0
Estonia	10.0	9.7	9.9	12.3	13.7
Latvia	18.3	14.4	13.8	14.5	14.6
Lithuania	16.4	14.1	13.3	14.1	16.0

*Source:* European Commission 2001.

A further factor concerning the social costs of the transformation is the decrease of the real value of public spending, which affected mostly health care and public education. Resources have been continuously extracted from these spheres and there has been no systematic reform or transformation. Taking Hungary as an example, statistical data show that health care expenditures have shrunk almost by one half during the decade of the transformation. The share of health care expenditures in GDP has fallen from 9.8% in 1990 to 5.6% by 1998 (investments worth 2 billion Euro are missing from the system).

This is a clear demonstration of the principle of “converting the modernization deficit into a social deficit”. The situation of public education is somewhat different. Although, expenditure on public education decreased significantly, it is still performing its main functions, mostly due to its fine traditions. In Hungary, education spending within the GDP fell from 5.8% in 1990 to 4.6% in 1999. It is, however, short-term thinking to seek savings in education when everyone is speaking about the knowledge-based society. Several CEECs, including Hungary, still have quite favourable competitive advantages in this sphere, but these are rapidly deteriorating.

Summing up the above, the costs of the fundamental restructuring of the economy have been covered mostly by internal resources. Foreign direct investment has played an outstanding role in the actual transformation of industry in most CEECs (especially in Hungary, the Czech Republic and Poland) but the total amount of FDI (around. \$100bn for the 10 CEECs by 2000) is still a small part of total restructuring costs. As a result, resources have been extracted, basically from population consumption and public spending, within which social protection, education and health care have been the greatest victims. This is why wages in most CEECs are not only lagging behind the EU average, but also behind the economic performance of individual countries.

However, in those countries where transformation was successful and on the basis of the new economic structure, economic growth is proving to be sustainable, and society can be compensated in the future from the economic wealth created.

### **Major challenges of EU accession**

Some of the expectations of the EU are posing certain pressure on candidate countries. The financial expectations that follow the Maastricht criteria are hard to match with several social targets. The requirement of reducing the State household deficit and the State debt, parallel to pushing down inflation to EU average, causes problems for Member States as well. Candidate countries have a much more difficult situation, since they have to solve several problems at the same time. Cutting public spending and raising social standards in line with the

European Social Model is hard enough. But at the same time carrying out massive infrastructure development projects and environmental investments (motorway construction, impacts of the EU directive for heavy weight vehicles, directives on waste handling and public utilization densities) is rather difficult. These investment needs are estimated to be around 25 - 30% of the GDP of candidate countries in the next 5 to 10 years.

Wages should catch up step by step, but inflation should go down at the same time. Competitiveness should be improved at a time of increasing wages and falling exports (due to stagnating EU economies). Curbing inflation has another impact, which endangers the fulfilment of other economic goals. To push inflation down implies the maintenance of relatively high interest rates, which leads to the real appreciation of CEEC currencies. The strengthening of these currencies against the Euro endangers export performances, puts a squeeze on SMEs and drives unemployment higher.

It would be a positive sign if foreign investors, who only base their project on cheap labour, start to leave these countries, while a parallel tendency could also emerge, when new investments resting on more value added and human capital would start to flow towards CEECs. Up until now there is only scattered evidence for that in some countries, especially in Hungary and Czech Republic.

### **Benefits and costs of enlargement with regard to economic and social impacts for Europe**

Parallel to the budgetary transfers and according to the Western European economists, the new Member States stand to enjoy two types of advantage:

- i) Some advantages linked to the suppression of tariff barriers (in particular for agricultural products), to the exploitation of economies of scale and, more generally, a more efficient allocation of resources;
- ii) Other advantages linked to the acceleration of investment, productivity and growth.



Seen from the Western point of view, accession is therefore considered as a trampoline destined to quicken the pace of the catching up process, to complete the transition and therefore to accelerate integration.

The European Union is also set to enjoy some advantages. The accession of the new members should reinforce the productive potential of the EU and give a boost to its growth, even if in more modest proportions.

Some of the applicant countries are still overheavy in traditional production segments (agriculture, heavy industries) with a low added value. These economies risk being forced to import goods and services with a high added value from the EU, thus further widening their trade deficits. They will also have to face up to competition from the countries of the EU in a context of heightened commercial integration. This competitive pressure raises the question of the reorganization or even the programmed decline of the traditional sectors (agriculture, steel, mining and shipbuilding industry and in Poland, heavy industries in the Czech Republic). A potential exodus of graduates towards the EU could also hinder the capacity of the new Member States to catch up with the productivity levels.

New influxes of labour could appear, whether in the form of permanent emigration or seasonal or daily cross-border influxes (Poland-Germany, Baltic Sea countries). These potential influxes are a very sensitive political issue for two countries that are particularly concerned. According to certain studies, Germany and Austria could absorb 75% of migrants from Central Europe. But this remains difficult to forecast, as these phenomena depend to a large degree on the pace of convergence of living standards and the employment situation in the EU and could remain relatively modest compared to previous waves of immigration (the Spanish and Portuguese in France, for example). Transition periods in the area of freedom of movement have been introduced in these fields.

Competition will be heightened in the traditional sectors (textile, metal and car industry) and in certain types of agricultural productions, particularly cereals and meat.

The social, economic, commercial and demographic situation of European agriculture will witness a far-reaching transformation as a result of enlargement. Two countries alone, Poland and Romania, make up 56% of the agricultural surface, 60% of the production and almost 80% of agricultural employment in the new Member States and applicant countries. For the European Commission, simply extending the CAP, especially in view of the fact that EU prices level are higher than those of the new members, would have meant a budgetary contribution estimated at 11 billion Euros per annum (or an increase of around 11% in the EU budget). According to its forecasts, accession should also lead to an increase in the surplus production of the new members and applicant countries, some of which are large agricultural producers.

As far as the EU regional policy and structural funds are concerned, enlargement will lead to a significant increase in the number of citizens and territories eligible for aid from the various programmes.

In financial terms, an agreement concluded in Copenhagen puts the cost of enlargement at 40.8 billion Euros (between 2004 and 2006), compared with the initial proposal (40 billion Euros), which represent less than 0.15% of the gross domestic product (GDP) of the EU15. From this sum should also be deducted the around 15 billion that these ten countries will be required to pay into the EU budget. Between 2004 and 2006, two thirds of the allocated sums will be earmarked for regional and structural aid. A quarter will be dedicated to the CAP and the remainder set aside to modernize public institutions or to ensure the safety of nuclear power plants. The 40 billion Euro amount (to 10 countries) seems rather symbolic, especially if we compare it to the yearly 100 billion Euro financial transfer from Western Germany to its new Länder in recent years.

## *Part IV*

# *WIDER EUROPEAN INTEGRATION AS AN OPPORTUNITY FOR THE NON-ACCEDING COUNTRIES*

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## *Towards a Pan-European Economic Space*

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This paper presents a new concept, the Pan-European Economic Space (PEES), as a contribution to thinking about East-West relations on the European continent and about foreign economic and political activities of the European Union (EU). The paper can thus be understood as an attempt to broaden the field of research on the Common European Economic Space (CEES), which is currently being discussed by the EU and the Russian Federation.<sup>22</sup> It is the expression of one interesting feature of the CEES concept, namely its potential for variable geometry. This CEES concept was first formulated on June 4, 1999 in the common

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<sup>22</sup> Samson (2002) "Establishment of a Common European Economic Area as a factor of Russia's sustainable Growth", *European Review of Economics and Finance*, Vol. 1 n°2, September, Lisbon, pp. 75-101; Ivan Samson, Xavier Greffe (2002) "Common Economic Space: Prospects for Russia-EU relations", RECEP White Book Moscow, 160 p. See also:

[http://europa.eu.int/comm/external\\_relations/russia/intro/index.htm](http://europa.eu.int/comm/external_relations/russia/intro/index.htm)

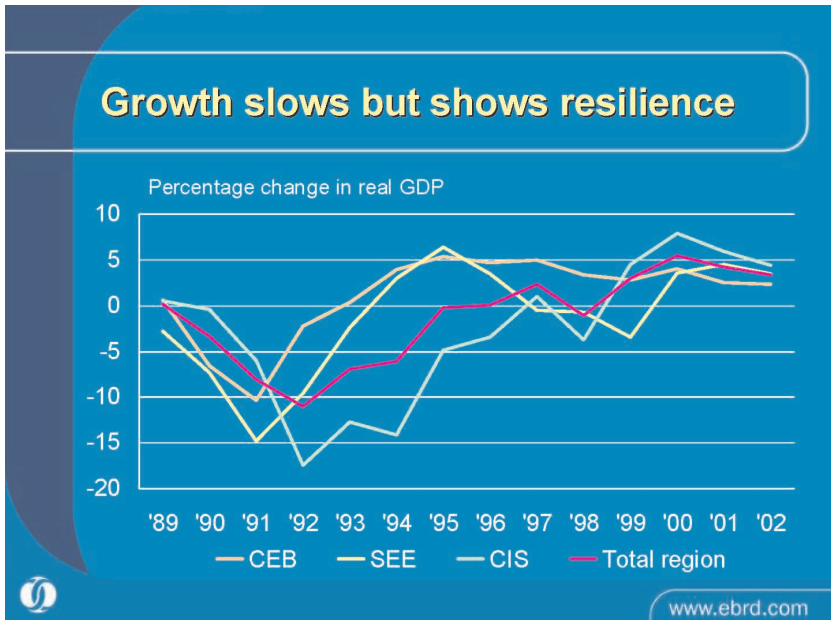
Strategy of the European Union on Russia and was reiterated a few months later in the first meeting between the new leaders of Russia and the EU, Vladimir Putin and Romano Prodi. At the UNECE Workshop on "Trade, Business and Investment in a Wider Europe" I focused mainly on the CEES, but I would like now to expand my theme. The idea of the PEES is very close to the new policy of a "Wider Europe Neighbourhood" currently being developed by the EU.

### **Why a Pan-European Economic Space?**

In 2004 eight Eastern transition countries will join the EU. This process is usually presented as the next major step in so-called EU enlargement. However, "EU enlargement" is a convenience term, which is in many ways inadequate and politically not very correct. It would be better to speak of the next step in European reunification. The two processes are different and completion of the reunification of Europe after World War II cannot be confused with EU enlargement. The latter is a smaller process and countries like Russia or Ukraine, for example, are not expected to be integrated in the EU in the near future. That means that EU enlargement will leave some major European countries beyond its scope. It is also important to note that the term "EU enlargement" reflects West European ethno-centrism.

On the eve of this major step towards European reunification, the situation of Eastern transition countries is highly contrasted. Acceding countries have seen strong economic growth and structural change in the last 10 years. They are even expected to bring the EU some growth impulses: the EU forecasts average growth for the period 2002-2004 in EU-15 at 1.6%, whereas estimates for the 10 acceding countries in the same period are 3.2% growth. The prospect of EU membership speeded up structural change and capital inflows, and provided a stability premium for these countries. By contrast, the economic, political and social situation in CIS countries remains disappointing and rather insecure. The starting position in these countries was worse and their structural changes in the late 1990s were very rapid, but their transition indicators are still far behind those of Central and Eastern European countries (CEEC), including Baltic countries, as shown in the graph 4.1.

Graph 4.1



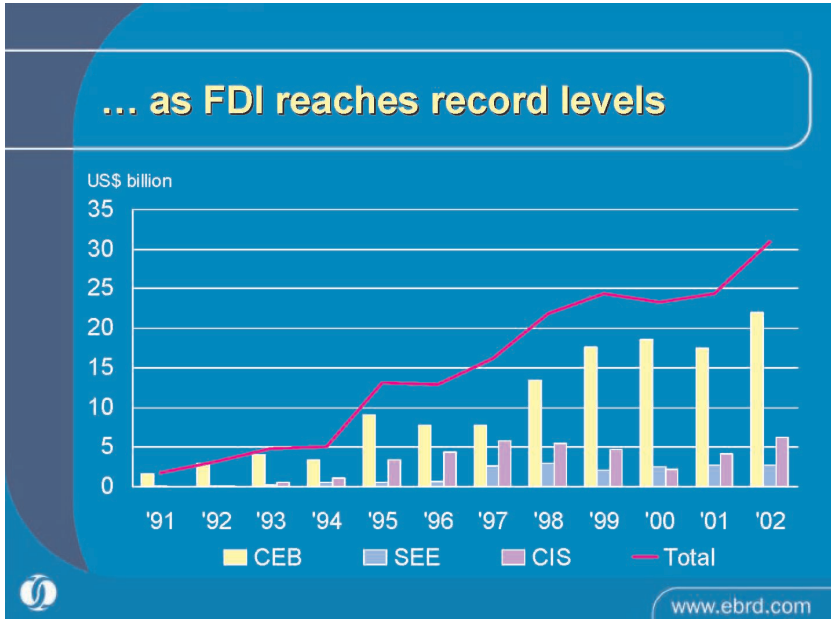
Note: CEB = CEECs and Baltic countries; SEE = South-eastern Europe

A slight catching-up process was observed in 2000-2002, but it is already disappearing in 2003. Moreover, although it is possible to detect a kind of nominal convergence consistent with the Baumol-Lucas-Barro paradigm, according to which less developed countries grow faster,<sup>23</sup> this convergence disappears when measured as a percentage of 1990 GDP. That means that the transformational crisis of the 1990s increased the gap between CEEC and CIS countries. The picture is the same if one considers FDI. FDI flows to CEEC in 2002 were four times higher than

<sup>23</sup> W.J. Baumol (1986) "Productivity Growth, Convergence, and Welfare : What the Long-Run Data Show", *American Economic Review*, 76, 5, p1072-1085; R.E. Lucas (1988) "On the Mechanics of Economic Development", *Journal of Monetary Economics*, Vol. 22, p139-199; R.J. Barro, X.X. Sala-I-Martin (1991) "Convergence across States and Regions", *Brookings Papers on Economic Activity*, 1, p107-158.

flows to CIS countries (calculation in terms of dollars per capita would give an even worse picture). And FDI dynamics are quite depressing: since 1997 FDI to CEEC multiplied threefold whereas flows to CIS countries stagnated (graph 4.2).

*Graph 4.2*



*Note:* CEB = CEECs and Baltic countries; SEE = South-eastern Europe

The overall picture is thus as follows:

- The transition process has increased the gap between the two parts of Eastern Europe;
- The process of accession by CEEC to the EU has strengthened this trend;
- Earlier experience of EU enlargement suggests a high probability that EU membership of CEEC will strengthen this trend even further.

The direct trade effects of EU enlargement for EU-CIS economic relations are not necessarily negative. There are positive effects, such as

tariff reductions and unified market enlargement, which are likely to compensate non-tariff barriers such as standards and norms. The concerns relate mainly to productivity effects connected with capital and know-how movements.

The concept of a Pan-European Economic Space (PEES) offers a way of filling this structural gap, encouraging mutual prosperity, stability and security by removing economic barriers between enlarged EU and the CIS countries. This would offer the EU better access to markets, which, along with China, are the most dynamic in the world, at a time when the developed world is trying to escape or prevent recession. It would also reinforce stability and security, which are increasingly recognised world-wide as highly desirable public goods. The USA has learnt from tragic events that the price of security is at least as high as the cost of restoring it.

### **The need for a new EU eastern policy**

At the "Sommet de l'Arche", held in Paris in 1989, the G24 mandated the EU to organise and coordinate support for reconstruction and development of post-communist countries. However, the EU has gradually shifted towards a different approach. The technical assistance activities developed through PHARE and Tacis programmes, which were very appropriate and highly focused on specific needs, have become less and less important compared with another policy, which has absorbed most of the EU's efforts and resources: the policy of EU enlargement. This is what we call the *enlargement paradigm*, i.e. prioritising the enlargement process as the way to support economic restructuring and political democratisation in the East.<sup>24</sup> It is true that this implicit policy shift was also a response to strong demand from several East European states, and the enlargement paradigm was very

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<sup>24</sup> Samson (1999) "The Eastern policies of Europe and the two worlds of transition"; 2<sup>nd</sup> EACES workshop "European enlargement to the East, but at what speed ?" Paris, March 22-23.

broadly shared in central Europe. But EU policy was never decided by third parties.

The enlargement paradigm was very strong during the period before Romano Prodi and well reflected by the words: "*Relevant EU Eastern policies should distinguish and not divide, instead of dividing without distinction*".<sup>25</sup> The analysis done before Romano Prodi's appointment was the following.

*"EU enlargement is the keystone of EU Eastern policies. Not because joining the EU is the final destiny of each transition country, but, on the contrary, because it plays the role of a prize for certain winners. However the development-enhancing effect of a selective and competitive approach is blurred by the lack of clear criteria for accession. No such approach can succeed unless it is transparent and sends consistent signals. As a matter of fact the latter are missing.(...) As a consequence of that, the positive effect of a sequenced enlargement tends to be reversed. Following the difficulties of reforming the EU and the cost of the first wave of accession, there is a risk that enlargement will end with this first wave, leaving many other countries and public opinions very frustrated. (...)A major result of aid to transition countries, mainly provided by the EU and EU countries, and of EU Eastern policies has been to increase former divisions and produce new divisions between these countries. That means that such policies do not bring any answer to the problems of the future of most transition countries and may even make solution of these problems more difficult."*<sup>26</sup>

This policy started to change after the appointment of Romano Prodi, when the EU opened the door to 10 candidate countries instead of 5, in the first accession wave. However, the enlargement paradigm remained dominant, so that instead of disseminating prosperity (such dissemination did not go beyond countries of the first circle) the EU

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<sup>25</sup> Samson (1999) op. cit. p. 10.

<sup>26</sup> Samson (1999) op. cit.



acted mainly as a magnet with divisive effects. The new enlargement policy has been beneficial for the accession countries, but, by definition, left other transition countries without any strong message.

Related problems attach to aid to the east and the bilateral approach towards economic co-operation. Analysis of government assistance, extended by western countries (mainly the EU countries) to transition countries, reveals a clear case of the *paradox of aid*,<sup>27</sup> which is that aid tends to be based on the quality of the recipient rather than the recipient's needs. Measured per capita, we observed that aid to the developed countries of central Europe and to the Baltic States was twice as generous as that to CIS countries. This suggests that donor countries followed the same signals as private capital flows. There are several reasons for this paradox, one being dissemination ability (the usual ceiling for absorption capacity of aid is 4% of GDP) and another being the fact that aid to transition countries benefited Western companies.

It is important to distinguish four types of EU aid to the transition economies:

1. Emergency and humanitarian aid, which should go to the poorest;
2. Development aid, which aims to compensate weakness of the state in providing conditions for investment (education, material infrastructure, energy, with particular attention to nuclear plants);
3. Specific aid for transition, which offers know-how transfers in public and private management and construction of market institutions;
4. Bilateral and multilateral loans to states to support budget and monetary policies.

The second and third types of aid mainly represent financing of projects and technical cooperation. The latter, which is 1/8 of total public aid, is best suited to countries with emerging economies where the educated

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<sup>27</sup> Ivan Samson – “Il est indispensable de repenser l'aide aux pays en transition” *Le Monde* 8.11. 1999.

and skilled workforce shows spectacular learning abilities. PHARE and Tacis programmes are typical of multilateral technical assistance. Between 1991 and 2001, PHARE delivered three times more resources than Tacis, and the gap is widening (in 2001, it is close to four times). PHARE and Tacis aid is modest in quantity and is likely to bring perceptible and durable effects: we are far from the limits of capacity absorption for such aid. The fact that technical cooperation per capita is higher for CEEC shows that the enlargement paradigm is alive and well and that EU support policies are not succeeding in reducing the structural gap between CEEC and CIS countries. On the contrary, they are helping to make the gap wider.

*Partnership and Cooperation Agreements* were set-up by the EU with most of the CIS countries. Such agreements came into force on December 1, 1997 for Russia, March 1, 1998 for Ukraine and July 1, 1999 for the other CIS countries (the exceptions are Belarus and Turkmenistan, with whom the PCAs have been signed but are not yet in force, and Mongolia, with whom there is only a Trade and Cooperation Agreement, signed in 1993). PCAs offer the prospect of closer cooperation with the EU for non-candidate countries and aim at preventing possible crowding-out effects after EU enlargement to the CEEC. The philosophy of these agreements is to create the conditions for a free-trade area, with the further prospect of developing free movement of services and capital. The sides grant each other most-favoured-nation status in trade and the absence of discriminations concerning goods, labour conditions and the establishment of companies. In addition, PCAs include several dispositions for law approximation that are very broad, but not very binding. The basis of these agreements is bilateralism, which means that the EU negotiates and passes the agreements country by country. This approach seems well-founded: the bilateral approach has proved to be much more efficient than the multilateral approach, for liberalisation of services as well as for regulatory convergence, as it is the case with the WTO. However the bilateralism in economic cooperation is structurally associated with negative side-effects and crowding-out effects: for example when the EU opens its borders to Russian steel, steel exports from Ukraine and Kazakhstan to the EU suffer from this measure.

As it was the case with the enlargement paradigm, the bilateral approach of EU economic cooperation is associated with divisive effects, suggesting that revision of EU policy is called for.

## **The lessons of research on the Common European Economic Space**

The RECEP White Book shows that the CEES can be an important lever of sustainable growth for Russia, and that it represents something much more sophisticated than a traditional free-trade area, a customs union or recognition of the EU *acquis communautaire*. The CEES is both a final aim and an economic mechanism. The final aims of this space are: to implement the four fundamental freedoms for goods, services, capital and persons; to achieve an intensive exchange of know-how and capital through FDI; and to support strong modernisation policies. The importance and the specificity of Russia make any reference to past experiences inadequate and successful creation of the CEES could contribute to the economic and social development of all Europeans.

Achievement of this long-term objective requires implementation of the CEES as an economic mechanism for changing the path of growth and the path of reforms in Russia. The CEES between Russia and the European Union has first to be considered as a *co-development path* that will define, step by step, its actual content. As a co-development path the CEES offers a way for Russia to find a *virtuous growth cycle* that could become sustainable. It is dependent on adequate positive interactions between development of trade liberalisation (the small scale of the Russian domestic market makes the EU market vital for modernisation of the Russian economy), investment and know-how flows, and institutional adjustments. Lack of parallelism between these three essential pillars would induce inefficient reorganisation and could even generate tensions. The economic mechanism of the CEES could organise the whole opening process of the Russian economy, starting with WTO accession. In its movement towards WTO accession, Russia has made the important choice of "large openness" as opposed to "small openness". The nature of Russia's negotiations on bound tariff rates, which will be progressively reduced, suggests that Russia will benefit from a 6-8 year "window" in order to implement needed adjustments.

This is not a long time. EU support is essential for Russian accession to the WTO, and active partnership within the CEES for modernisation of Russia's production is a condition for making this accession a success.

This co-development path is of *mutual interest* because creating a Common European Economic Space is a win-win project for the two main forces on the European continent: the Russian Federation and the European Union. For Russia it offers a way to diversify an economic system based mainly on the exploitation of natural resources, and to organise a diversified competitive economy based on relevant investments. For the European Union, Russia is a major foreign trade partner in absolute terms and presents opportunities for capitalisation of EU strengths through increased complementarities. The chief aim could be best defined as sustainable growth for all the inhabitants of Europe. Russia and the EU may have very different levels of development but, between them, they also have all the ingredients of success at a time when globalisation and knowledge are the main sustainers of development. Both parties will gain increased prosperity, stability and security from creation of the CEES.

The challenge of the CEES goes beyond creation of a free-trade area and focuses on transformation of the development model of the Russian economy. Despite good performance by the Russian economy after 1998 rouble devaluation and the rise of world energy prices, Russia faces difficulties in transforming its economic surplus into a basis for sustainable development.

Russia's macroeconomic health since 1999 is reliant on exports: the increase in the trade surplus since 1998 has been 2-2.5 times greater than increase in GDP, which has grown by over 20% in the last three years. The trade surplus exceeds \$60 billion, and the net balance is \$40 billion. Thanks to this situation, the budget surplus is close to 5% of GDP and debt has been reduced by \$2.7 billion. However, since two thirds of Russian exports are primary goods, Russia's growth is dependent on evolution of world market prices. Lack of significant increase in imports of machinery and equipment also gives cause for concern. The overall investment rate relative to GDP remains low, at around 15-16% over the last five years, which is far below the rates that are needed for economic take-off in emerging economies (between 25%

and 35% in a medium-term perspective), and is even below investment rates in developed EU countries. The hypothesis of export-led growth is not convincing, and there is nothing to indicate that such growth, which has benefited from the devaluation of 1998, is sustainable. This is also indicated by the balance of public finances, which remains highly volatile. We are still far from a Russian economic boom based on multi-sectoral productivity increases and strong investment activity. It is thus fair to say that Russia remains mainly a rent economy and a victim of so called Dutch disease.<sup>28</sup>

The situation is thus more fragile than superficial reading of the macroeconomic indicators may suggest, and two issues have to be considered in order to clarify the challenges for the Russian economy. First, can Russia rely only on primary goods or should it look harder at the new situation created by the knowledge economy and flexible specialisation in industry? And second, can foreign direct investment (FDI) help to bring sustainable growth by boosting current low investment rates? It seems that both the EU and Russia would benefit from integrating within a new type of economic space where a productive partnership could mobilise their respective resources for their common interest. The challenge here is not only trade but also capital and know-how flows. Moreover, dynamic strategies underlying implementation of the CEES must consider new features of the world economic environment. Growth relies on new productive paradigms, such as the knowledge economy and environmental values. Orientation towards the knowledge economy is very consistent with Russia's human capital endowment. This means that themes such as intellectual property rights, environment-friendly production or SME development have to be at the top of the agenda.

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<sup>28</sup> Dutch disease is the deindustrialization of a nation's economy that occurs when the discovery of a natural resource raises the value of that nation's currency, making manufactured goods less competitive with other nations, increasing imports and decreasing exports. The term originated in Holland after the discovery of North Sea gas. (See <http://www.investorwords.com/cgi-bin/getword.cgi?1604>)

## **Econometrical demonstration of the relevance of a Common Economic Space (CEES)**

Econometric simulation shows that the best formula for CEES is free-trade measures *completed by strong modernisation policies thanks to intensive FDI and know-how flows*. The economic efficiency for Russia of such a CEES concept is manifest, since it will lead to the highest GDP increase, strong expansion of imports and exports, a higher share of manufactured goods in exports, and improved welfare in Russia. Two pieces of RECEP statistical research helped to demonstrate the relevance of the CEES.

In the first piece of research, we show what could be the effects of the CEES on the Russian economy after EU enlargement. Using the GTAP model, we started with the effects on the FSU in 1999 of the enlargement of the EU to the CEEC7, without (S1) and with (S2) an integration effect inside the enlarged EU.<sup>29</sup> Two alternative concepts of the CEES were then estimated: in the first concept the CEES is only a free-trade area (S3) and in the second concept the CEES is both a free-trade area and a zone of productivity gains due to FDI and modernisation efforts (S4). The results show that this last concept is the best possible for Russia, whereas a simple free-trade area generates only small gains. The results are very significant and give a clear indication of the content, which the CEES requires in order to become a genuine lever for Russian development.

<i>Nature of the SIMULATION</i>	<i>Variation in FSU GDP</i>
S1: EU Enlargement to CEEC7	=
S2: EU Enlargement to CEEC7 with integration	+
S3: CEES with EU25 as free-trade area	+
S4: CEES with EU25 as free-trade area & FDI	+++++

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<sup>29</sup> The integration effect is simulated by a strong increase in substitutability between domestic and imported goods (Armington elasticity).

	<i>Welfare effect*</i>	<i>Import</i>	<i>Export</i>	<i>Terms of trade**</i>
S1	-157	- 0.25	-0.14	-0.09
S2	+758	+0.79	+0.27	+0.45
S3	-268	+8.54	+6.09	-0.38
S4	+6416	+10.23	+5.22	-0.19

\* Variation in mln of 1997 \$

\*\*Terms of trade index: index of export prices / index of import prices.

*Note:* An increase means that export prices grow more than import prices; these changes originate from tariff changes and subsequent relative price changes.

In the second calculation, we determine if the trade flows between Russia, other CIS countries and Europe operate in the right way or not.<sup>30</sup> Normally trade levels should reflect the relationship between economic sizes of the trading partners allowing for effects of distance. If real flows do not tally with these virtual normative exchanges, it is likely that some distortion of trade is occurring due to administrative manipulations, leading to welfare loss. We used gravity equation methodology, which suggested that theoretically, the creation of the CEES could lead to six-fold reduction of trade between Russia and the CIS, and four-fold increase of trade between Russia and EU countries. Macroeconomic modelling proved that there is strong potential for trade through the CEES. Gravity measurement showed that mutual trade between the EU and Russia could be multiplied by several times. Realisation of this potential is not basically detrimental to trade between Russia and other CIS countries, although Russia-CIS trade is now higher than is economically justifiable.

In a second step we added additional variables to the gravity equations: an extra effect of 80% trade increase was demonstrated, mostly due to decline of the black market and improvement in protection of property

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<sup>30</sup> Oxana Koukhartchouk, Mathilde Maurel (2002) "Institutions and Trade in Transition Countries", RECEP working paper, Moscow, 24 p.

rights. Overall, therefore, institutions influence trade in the expected way: more freedom attracts foreign partners and stimulates bilateral trade flows. Higher tariff and non-tariff barriers constitute an impediment to mutual trade. By contrast, legislation, which opens up on foreign ownership of business and land, and permits repatriation of earnings, treating foreign and domestic companies equally, leads to larger trade volumes. Trade is positively and significantly affected by existence of a well-functioning financial and banking system, which can efficiently finance trade business. Higher wage and price flexibility produces higher bilateral trade, and better protection of property rights raises incentives to engage in bilateral trade activities. Finally the extent of the black market influences trade in the expected way: more informal, unregistered activity reduces the level of official, registered trade.

It is interesting to note that another simulation of CEES was made with the same purpose by the Centre for European Policy Studies in Brussels (CEPS), using the same tools (gravity equations and GTAP model) with different methodology.<sup>31</sup> The conclusion of that simulation was that the economic impact of a Russia-EU free trade agreement which is both broad, in terms of sector coverage, and deep, in terms of addressing regulatory constraints upon trade, will be large relative to an agreement that is limited to the removal of tariff restrictions on trade in goods. A broad and deep FTA could have a profound effect on the level of income and the rate of growth in Russia through increasing flows of trade, investment and technology, via improvements in the efficiency of services and by providing a foundation for the locking in and intensification of market reforms. The message is clear: positive effects from FTA agreements between the EU and CIS countries require more than mere trade liberalisation. Positive effects are only obtained when

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<sup>31</sup> These are so far unpublished studies owned by the EC : Paul Brenton (2002) "The Economic Impact of a EU-Russia Free Trade Agreement"; Paul Brenton, Natalia Tourdveva, John Whally (2002) "The Economic Impact of a Free Trade Agreement between Russia and the EU: Numerical Simulations using a General Equilibrium Trade Model"; Paul Brenton, Miriam Manchin (2002) "Trade in Services, Foreign Direct Investment and Technology Transfer: Implications of an EU-Russia Free Trade Agreement for Economic Efficiency and Growth".



the FTA is complemented by intensive capital and know-how flows. The RECEP White Book showed that these flows may take the form of foreign direct investments, but in the case of commodity exporters accruing huge capital sums (Russia, Kazakhstan), the flows may be achieved by mere purchase of know-how and equipment or even the acquisition of EU companies. The CEPS study showed also that a free-trade agreement with Russia could have adverse consequences on other European CIS countries and most notably Ukraine if structural changes do not take place. This confirms our second conclusion, according to which bilateral FTAs have negative crowding out side effects.

### **Pan-European Economic Space: a lever for the unity of Europe**

After its enlargement to 10 countries in Central and Eastern Europe (8 in 2004 plus Romania and Bulgaria in 2007), the EU has to show that it has a concept for helping the other transition countries in the CIS to resolve their problems. Reduction of the development gap between accession countries and other transition countries is a critical issue, and the initial task is to prevent further widening of this gap.

Research conducted on the CEES between the EU and Russia provided highly valuable conclusions. The CIS countries face basically similar structural problems, the main difference being the degree of each economic malaise (weakness of the state, weakness of economic institutions, difficulties in escaping the trap of a rent economy, corruption, barter and shadow economy, difficulties in building real firms with competitive and profit-seeking behaviours, low investment level and poor productivity, etc.)<sup>32</sup> and possession or lack of commodities that can be sold on world markets. In order to address these problems the EU and its partners have to invent mechanisms and incentives for building a single market with the CIS based on implementation of the four fundamental freedoms (free movements of

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<sup>32</sup> Jacques Fontanel, Ivan Samson (2003) "Les liaisons dangereuses entre l'Etat et l'économie russe" L'Harmattan, Paris, 212 p.

goods, services, capital and persons) complemented by a form of regulatory convergence (selective use of the *acquis communautaire*) and by strong flows of capital and know-how.

Such a Pan-European Economic Space should be built on the basis of tailored and complex agreements with regions consisting of groups of countries. The approach of negotiating PEES with several countries having common features, even if not strongly or formally integrated, has several advantages. It represents a half-way house between bilateralism and multilateralism that one could call *regiolateralism* (the EU term is “regional cooperation”). The justification for promoting forms of *regiolateralism* in relations between the EU and CIS countries are as follows.

- *Regiolateralism* echoes the Marshall Plan spirit, where US aid was conditioned by mutual trade development between the countries of Western Europe;
- It prevents mechanical crowding-out effects connected to bilateral FTA, without entering the overall approach of multilateralism, which is not the optimal framework for liberalisation in services and for regulatory convergence;
- The political message of opening from the EU is much stronger because instead of making a single state "negotiate" with 25 EU states, it shows respect by the EU for regional peculiarities and regional integration measures.

Regional cooperation is not new for the EU, which already has experience of the ACP (Africa, Caribbean, Pacific) agreements: the so-called Lomé conventions, successively organising preferential trade with 71 developing countries. In 1989 the EU and the six-State Gulf Cooperation Council signed a cooperation agreement, in 1993 the EU-Central America Framework Cooperation Agreement was begun, followed by the EU-Mercosur Interregional Framework and Cooperation Agreement in 1996 and an agreement with the Andean Community in June 1999. Summits with the five Western Balkan countries are organising the process of further integration of these five states with the EU, and there is also a Euro-Mediterranean partnership

with 12 States from this region. This list is not complete and is merely intended to show examples of successful regional cooperation by the EU with very different regions and in very different forms.

Surprisingly, such regional co-operation never took place with transition countries, probably because of the enlargement paradigm, which gave priority to bilateralism. The fact that the EU is preparing deeper integration with transition countries, including forms of legal approximation on the basis of the EU *acquis communautaire*, is not a sufficient explanation. Deeper integration is also being developed with the Mercosur countries, where the aim is to move towards association agreements, and an economic partnership agreement is being prepared with ACP, not to mention the Western Balkans, which are sooner or later expected to become EU members.

*Regiolateralism* would be the most adequate form for the EU to negotiate building of the Pan-European Economic Space, since:

- It is perfectly suited for negotiations that combine trade and regulatory issues;
- It will show readiness of the EU to take certain existing integration processes between CIS countries into account.
- It will help to keep a special position for Russia. The CEES, which is currently being discussed, relies on the idea of a strategic partnership between the two parties. The building of PEES should not give the impression of diluting the CEES process (which is more advanced) and the special position of Russia.

The PEES model, based on CEES, could be extended to several CIS sub-regions as Western CIS, Caucasus and even Central Asia. It could also be based on other sub-regional geometries. There is also potential for the PEES to become the basis of EU cooperation with the Mediterranean region or Middle East.

The development of a PEES would thus represent a major change in the EU approach to the "other" transition countries, which are not involved in the accession process. It will show that the EU has a concept for the

East as a neighbour and a close partner, beyond the enlargement process.

Building PEES means a radical change in the world economy as well as formation of a large economic belt around the enlarged and unified EU25. Understanding of PEES as a space with free circulation of persons and goods is a very exciting prospect, representing an unprecedented level of European unification. But is this realistic? Is it really thinkable in a near future? The answer is yes for two reasons. The first is the asymmetry of economic relations between the EU and its eastern neighbours (Russia, Western CIS, Caucasus, Central Asia), which paradoxically pleads for further economic integration and will facilitate it. Russia, the EU's biggest partner in the region, was the fifth largest source of EU imports and sixth largest destination for EU exports in 2001, but represented only 1.5% and 1.1% of its imports and exports respectively. On the other hand, EU15 represented 29.5% of CIS exports and 35.2% of CIS imports in 2001.

For Russia the figures are respectively 33.3% and 45.1%, for Ukraine 19% and 27.2%, for Belarus 8% and 15% and for Kazakhstan 30.2% and 21.9%. If we consider EU25, the overall share of the EU in CIS trade will be increased by 3%. The CIS is already more integrated with the EU than with itself as regards trade. Removing economic barriers will have thus small economic impact on the EU (CIS GDP is only equal to that of Spain) but will have major impact on CIS countries. Therefore a potential negative impact on EU companies due to trade liberalisation is not a serious factor and should not be a serious obstacle to building of the PEES, which presents huge opportunities.

The second reason why PEES is realistic is that the EU recently officially stated a commitment to its "new neighbours". In a very important document of March 11, 2003 the EU defined the new orientations of its relations with the "Wider Europe Neighbourhood".<sup>33</sup>

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<sup>33</sup> "Wider Europe – Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours", COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT, 26 p.

The point is that in addition to EU enlargement, the EU has to show its willingness to open broad and generous co-operation with its neighbours, which are not concerned by this process. It is time to show that the EU has something important to propose to its close partners and that enlargement is not the unique tool. This represents a major change in EU policy and a move by the Commission away from the enlargement paradigm. This was not a brutal change, because the process started at least as early as 1999, but it is clear that the approach of 2004 made creation of a new paradigm into an urgent priority. The Wider Europe Neighbourhood (WEN) paradigm means the building of a belt of democracy and prosperity around Europe, which will ensure shared stability and security. It is interesting to note the prevalence of geographic proximity as a criterion for definition of strategic partnerships, which reflects the importance of the integration process in the EU's international relations. What is the Wider Europe Neighbourhood? The content will of course be more precisely defined, but the guidelines are already quite clear. The EU will strive to disseminate its values and prosperity within this "*ring of friends*". Free movement of persons, goods, services and capital should be ensured and the economic dimension is very close to what was proposed for the CEES by the RECEP White Book. It is clear that this new paradigm extends the first approach proposed for the CEES and that the building of a PEES is quite compatible with the Wider Europe Neighbourhood. They rely on the same vision, and the PEES is ideally suited to found the economic dimension of the "*ring of friends*" proposed by the EU. However, the discrepancy is that the Wider Europe Neighbourhood suggests a bilateral approach, country by country, which is less than optimal for the reasons set out above. *Regiolateralism* would appear friendlier in this respect.

Success of the PEES also requires attention to remarks made by Russia in discussions concerning CEES.<sup>34</sup> Beside the usual – and sometimes

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<sup>34</sup> Vladimir Mau, Vadim Novikov (2002) "Economic relations between Russia and the EU: the Space of Choice or the Choice of Space?" (in Russian), *Voprosy Ekonomiki* no. 6.

not unjustified - request for additional liberalisation by the EU side, the Russians support the idea of an "open" scenario, i.e. that the CEES should not rely on preferential forms of cooperation regarding third countries, which could become obstacles to overall trade development, but that it should rely on integration forms transferable to third countries. In other words, Russia will avoid becoming "captured" in a CEES with the EU that will constrain its trade with third parties. Although this request is largely symbolic, because the CEES is oriented towards increasing the competitiveness of Russian companies and not towards giving trade preferences, the Russian fear of a lock-in with the EU should be considered.

Another argument already heard against the PEES is the following: "Well, with the PEES, what you offer is a trick to avoid letting us into the EU!" This remark is typical of the enlargement paradigm, which has gained acceptance beyond the EU. It relies on the idea that there is no salvation outside EU membership, forgetting one very important fact: that the accession process is associated with extremely high constraints and costs. The cost for sharing the decision process of the EU and benefiting from its (decreasing) structural and agricultural policies is the loss of a part of national sovereignty and of autonomy in economic policy. Precise calculation of the costs for accession countries is of course a difficult exercise. But there are some partial estimates. For example: *"realising massive infrastructure development projects and environmental investments (motor way construction, impacts of the EU directive for heavy weight vehicles, directives on waste handling and public utilisation densities) is almost beyond rationality. These investment needs are estimated to around 25-30% of the GDP of candidate countries in the next 5 to 10 years"*.<sup>35</sup> The cost to Poland of introducing the 320 EU environment directives could represent 4-8% of

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<sup>35</sup> Béla Galgóczi (2003) "Social and economic cost of EU enlargement – from the point of view of the new member states", prepared for the UN–ECE conference: "TRADE, BUSINESS AND INVESTMENT IN A WIDER EUROPE" Palais des Nations, Geneva, 7 April 2003, p. 12.

current GDP for the next 20 years<sup>36</sup> and the cost to Poland of complying with EU directives on standards and safety rules in transportation would be somewhat less.<sup>37</sup> In 1997, the Commission estimated the cost for the 10 CEE candidate countries of integrating the whole *acquis communautaire* in national legislations at \$120 billion.<sup>38</sup> There are even voices expressing the idea that the EU regulatory system may draw the new EU accession countries into "a poverty trap".<sup>39</sup> Without going to such extreme views, the point is thus to find forms of economic integration with the EU for third countries that maximise the benefits and minimise the costs. This is what the Pan-European Economic Space can offer.

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<sup>36</sup> Alan Mayhew "Financial and Budgetary Implications of the Accession of Central and East European Countries to the European Union" Working Paper 33, Brighton: Sussex European Institute, cited in Patrick A. Messerlin, *Measuring the Costs of Protection in Europe*, Washington, DC: Institute for International Economics.

<sup>37</sup> Alan Mayhew and W. Orłowski "The Impact of EU Accession on Enterprise Adaptation and Institutional Development in the EU-Associated Countries in Central and Eastern Europe" London: European Bank for Reconstruction and Development, 1998, cited in Messerlin, *op. cit.*

<sup>38</sup> [http://www.eu2001.se/static/fr/eu\\_info/utvidgning\\_effekter.asp](http://www.eu2001.se/static/fr/eu_info/utvidgning_effekter.asp)

<sup>39</sup> Anders Aslund (2003) "East-Central Europe & the CIS: Economic divergence?" Meeting of the UNDP/RBEC Advisory Board, Moscow, May.

## ***EU Interests in the Caspian Sea Region***

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The arrival of the 10 new members acceding to the EU, in 2004, will change the energy landscape of the European continent. This change no doubt will have significant implications for EU energy markets and will provide investment opportunities to the EU energy system. The EU is already the largest energy importer in the world and the second-largest consumer. According to EU data, its dependence could reach 70% of import supplies by 2030. By that time oil imports could account for 90%, gas consumption – 70% and coal imports for up to 100%. Without doubt the forthcoming enlargement will reinforce the above-described trends, despite the fact that some candidate countries are producers of some primary energy products. The opening of new EU gas and power markets to the east will produce major challenges, despite quite wide opportunities regarding trade and investment.

European energy interests in the Caspian region include: the involvement of European energy companies in the region and a growing interest in the Caspian region as a current and future source of energy for use in Europe itself.

The major European oil and gas companies are already well represented in exploration and production projects in the Caspian Sea region. British Petroleum (BP) has the leading role in the two biggest projects in Azerbaijan being the only successful projects to date in that country. At the same time, the company's decision to sell its stake in Kazakhstan's Kashagan field reflected its very small share in the project and underpinned its heavy exposure in Azerbaijan, which has become the company's focus in the Caspian Sea region.

However, without appropriate transport routes the whole business would be impossible. At the present time the transit routes are fragile, where security remains a substantial problem. The major European energy



companies are also well represented in pipeline projects in the Caspian Sea region. For example, BP has the leading role in the Baku-Ceyhan project, where Eni, Statoil and TotalFinaElf are partners (with a combined share of 58%). Other European companies, as e.g. Shell, have been reported to be considering taking a stake in the project. While some European companies, as e.g. Agip, BP or Shell, are involved in the CPC pipeline, others, as e.g. TotalFinaElf, are examining a possibility of the oil export pipeline from Kazakhstan across Iran - a project in which US companies would not be able to participate (see the Map 1).

European companies have also been active in the electricity sector in Kazakhstan, but they have been less successful in this field. Among the problems encountered by the international power companies, non-payment for energy supplies became a crucial obstacle and a point of conflict between the new owners and the government. The problems remained acute despite the government of Kazakhstan embarked on a process of liberalising electricity tariffs in the mid-1990s. These difficulties, together with a lack of transparency from the governmental side finally persuaded a number of foreign utility companies to pull out from Kazakhstan. Among them a Belgian company Tractabel, which found itself unable to collect more than about 60% of payments in Almaty, or International Power from the UK.

In this respect, European energy interests in the Caspian region are particularly significant. Firstly, there are European energy companies involved in all spheres of energy in the region, as oil, gas, coal, electricity, but particularly in the upstream sector of the oil and gas industries. Secondly, Europe has a growing interest in the Caspian region as a current and future source of energy for use in Europe itself. The region's oil is already exported to Europe and there are many plans for gas to follow, with pipelines being proposed to carry the Caspian Region's gas to the heart of the European market. The Energy Charter, which seeks to address each of the two areas, is just one of a series of initiatives aimed at helping to unlock the entire Caspian region's energy resources.

Europe's interest in Caspian energy goes far beyond the investments by European energy companies. The US portrays the Caspian Sea region as

a potential replacement for the country's oil imports from the Middle East, but the natural market for Caspian oil and gas is in Europe. Almost all the oil exported from the former Soviet Union is sold into Europe and even those US companies that currently produce oil in the Caspian deliver it to their refineries in Europe. The reason is mostly economic: Russian and Caspian oil cannot be loaded into commercially attractive tankers large enough to make crossing the Atlantic on a regular basis feasible because of restrictions on the size of tankers passing through the Bosphorus and Danish Straits.

Europe as a whole imports some 560 million tonnes of oil per year, of which around 40 million tonnes (7%) come from the Caspian region. Although oil exports from the FSU will become more diversified in the years ahead, Europe will remain the most important market for Russian and Caspian oil. Pipelines to deepwater ports will have a capacity of some 2.5 mbpd at a time when total oil exports from the FSU could be approaching 10 mbpd. Assuming that the Baku-Ceyhan pipeline allowing Caspian oil to be loaded into 300,000 dwt tankers will be completed and sold into the US on a regular basis and the Russia's Druzhba pipeline will be extended to the Adriatic allowing Russian oil to be exported to the US too, pipelines linking Russia to China will permit a big increase in exports eastwards (map 4.1).

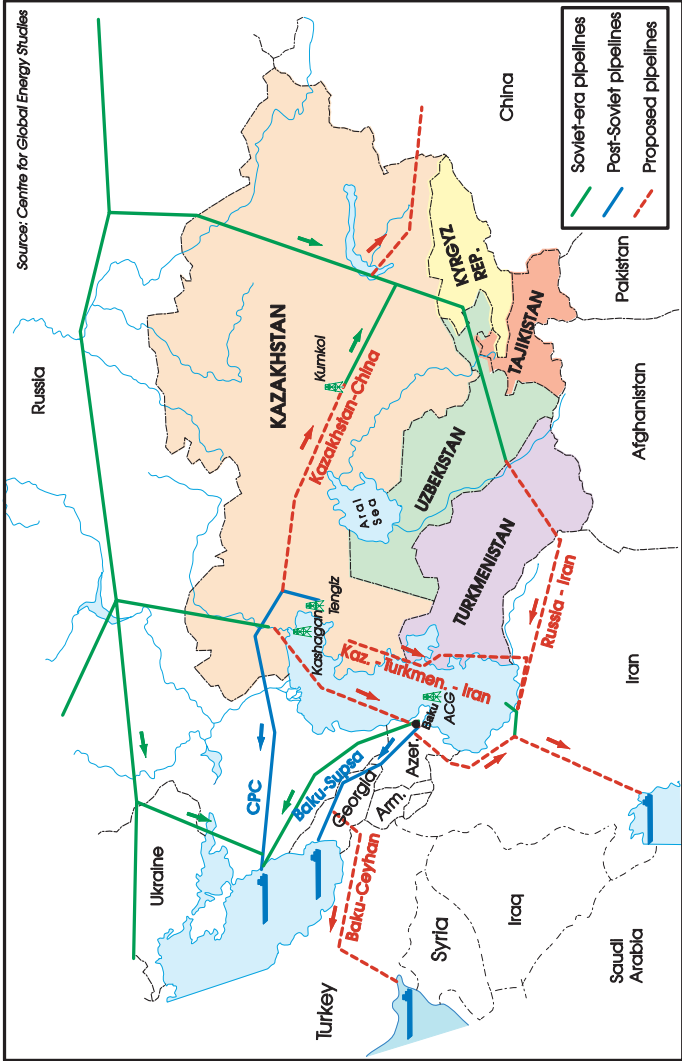
However, gas trade tends to be more regional, with producers and consumers usually linked by pipeline. At present, almost all the gas exported from the Central Asia goes to Russia, with a very small amount sold to Iran by Turkmenistan. Europe imports gas from Russia, North Africa and Nigeria. But as Europe's indigenous gas reserves are depleted, the region will increasingly turn to the states of the former Soviet Union for additional supplies. While Russia will remain the region's biggest gas supplier to Europe, Central Asian states might have a growing role to play, exporting gas into both northern and southern Europe.

Geographically and politically, Europe remains the most natural market for the Caspian energy. This indication is given by the fact that the obvious export routes conduct to the north and west, into Europe, and

the European Union, which has itself become concerned about the future security of the region's energy supplies.

The forthcoming EU enlargement will change the energy landscape of the European continent and will have significant implications for EU energy markets. The opening of new EU gas and power markets to the east will produce main challenges as well as wide opportunities for investment and trade.

Map 4.1



As the gradual accession to the EU of 12 new States (10 plus soon Bulgaria and Romania) is becoming reality, it will obviously be followed by crucial changes in EU's structure, internal and external activity mechanisms, having influence on the global politics and economy, including a policy toward its new neighbours. In a strategic perspective Ukraine considers the forthcoming EU enlargement as an important element of further European integration, which is to create new and wider opportunities for multilateral cooperation, having important political, economic and social consequences for Ukraine.

Contemporary economic policy of the Ukrainian Government has led to the establishment of permanent economic growth in the country and quite a stable macroeconomic environment. Ukraine is making further efforts to stabilize GDP growth not less than 8% within the next two years, which shall be achieved through increased investment, small and medium enterprise development, reforms of financial markets and administration, and tax reform, as an important prerequisite of launching Ukraine's integration process into the EU. Ukraine considers regulatory convergence with EU's laws and principles as another important step on its way to the EU. The bilateral protocol signed between the EU and Ukraine within the accession process of Ukraine to the WTO is a crucial factor for further economic development of the country, and at the same time it confirms Ukrainian commitment to bring its legislation in conformity with the rules and principles of the WTO as well as the EU.

Ukraine is concentrating its efforts at further enhancement of social and economic reforms to achieve a sustainable economic growth, to solve social problems, and to strengthen democracy. For Ukraine, its integration to the EU is not an alternative, but a priority precondition of its further development.

*(excerpted from the presentation of H.E. Mr. Mykhailo Skuratovskyi, Ambassador, Permanent Representative of Ukraine to the United Nations Office at Geneva)*



## *PART V*

# *CONCLUSIONS*

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Participants in the Workshop on “Trade, Business and Investment in a Wider Europe” had the opportunity to meet with high-level officials and experts representing Governments, international organizations, academic institutions, business and NGOs. As a result, they were able to:

- Learn about the benefits and costs of EU enlargement for future EU neighbouring countries in the areas of trade, business and investment
- Exchange views on how, after EU enlargement, Europe can respond to the new challenges for improved economic integration and cooperation within the region
- Consider how the promotion of integration among transition economies and with the enlarged EU can contribute to enhanced economic stability in Europe.

Above all, the Workshop highlighted the most important challenges confronting the countries that are soon to become the “new neighbours” of the enlarged EU. The main challenge will be to promote sustained economic growth and reverse the trend towards rising absolute poverty, increasing income disparities and high unemployment by further strengthening economic integration. Thus, promoting regional stability and friendly relations between the EU and its new neighbouring countries should be a priority.

In general, the non-accessing countries will benefit from simplified and enhanced access to the enlarged EU Single Market through the existence of common regimes and regulatory frameworks. One example is the EU common external tariff, which is lower than the individual tariffs of the

accession countries – with some exceptions, such as fishery products. However, specific implications of EU enlargement for non-acceding countries depend to a large extent on whether the countries concerned will benefit from a trade-creating effect or will suffer from trade diversion.

The enlargement, in itself, could contribute to lower transaction costs, in particular if it results in greater transparency, simplified procedures, harmonization and convergence of competitive conditions related to trade regulations. SMEs will be the first to gain from an environment where transaction costs are lower. Their already important contribution to employment and GDP throughout the European region could grow further if they have more access more training and are given more exposure to the Internet and electronic commerce.

Regarding investment, while enlargement will not necessarily cause a fall in the amount of FDI going to the non-acceding countries, it might affect its structure and reinforce sectoral imbalances. On the other hand, rising income in the newly acceding countries might also create new comparative advantages as well as export opportunities beyond the enlarged EU for non-acceding countries. Nevertheless, the prerequisites for attracting FDI in non-acceding countries are political stability, positive macroeconomic developments, progress in the transformation process and a friendly business climate together with active implementation of a trade facilitation environment. If this is not achieved, efforts to mobilize foreign investments will be wasted.

Liberalization, privatization and the restructuring of industry were the essential building blocks of the reform programmes of the Eastern European countries. These programmes were accompanied by structural and institutional reform, liberalization of foreign trade, price deregulation and a comprehensive legislative reform, all of which established conditions that allowed the shift from centrally planned economies to market economies. Some Eastern and Southern European countries, such as Russia, CIS and the Western Balkans, have advanced less in market reforms than most of the other Eastern European countries that will join EU in May 2004.



Therefore, the UNECE Committee for Trade, Industry and Enterprise Development (CTIED) at its seventh session, held on 13 May 2003, agreed that its 2004 session would be devoted to the issues of trade, industry restructuring and enterprise development in the UNECE region after EU enlargement. The CTIED will host an international forum in mid-May 2004 addressing those important issues, with a special focus on the interests of the non-acceding countries. The forum will provide an opportunity to continue in a more focused manner the discussion launched in 2003 during the UNECE “wider Europe” workshops on energy, trade, transport and environment. It will also try to identify those needs of concerned countries, where the international community, and the UNECE in particular, could be helpful. Discussions will take place on post-enlargement Europe and how the UNECE’s experience and expertise could greatly facilitate a wider regional cooperation. UNECE could make an important contribution through its existing work in trade facilitation, agricultural quality standards and e-business standards, the legal environment, regulatory convergence and enterprise development. As already shown in this publication, UNECE instruments provide the basis for many EU activities and legislation as well as a number of EU agreements with the CIS and Southeast European countries. In order to strengthen economic cooperation with the enlarged EU, there is a need for non-acceding countries to adopt and implement standards and legislation that are not identical to, but are harmonized with, the *acquis communautaire*. Both UNECE and the EU suggested that this contribution could be reinforced through joint activities and cooperation within the “wider Europe” initiative. Active collaboration between the EU and UNECE, and the various other concerned actors, will be an important contribution to meeting this challenge.

In conclusion, the contributors to this publication are convinced that the enhanced regional, subregional and cross-border cooperation will contribute significantly to overcoming disparities in the region, and is vital for achieving sustainable peace and prosperity in Europe. The UNECE, whose role since its creation over 50 years ago has been to promote economic cooperation and integration in its region, is ready to assist in strengthening cooperation among its member States, promoting economic development and stimulating integration of transition economies into the economy of Europe and Asia. Therefore, the

UNECE will concentrate its capacity building and implementation activities more on South-Eastern Europe and the CIS, including Caucasus and Central Asia. It will provide more advisory assistance and expertise to member States at their request. In promoting cooperation in post-enlargement Europe, its focus will be on the assistance in convergence of regulatory measures, such as technical regulation and standards, development of transport infrastructure (e.g. the Euro-Asian transport links), trade facilitation, cooperation in the fields of energy and environment and country-specific diagnostic and analytical reports. Many countries in Southern and Eastern Europe have to face the challenge of strengthening governance and democracy. A consistent part of it is the fight against corruption, which undermines economic efficiency and increases social disparities. The role of the State in encouraging and regulating the business community is still in the process of evolution in many of these countries and UNECE can assist in several sectors by offering focused programmes. UNECE is willing to extend its involvement in promoting good governance both at government level and in the corporate sector, which is one of the basic preconditions for successful enterprise development and stimulation of the knowledge-based economy, especially a dynamic services sector. Full integration of all member States in the wider European and international economy is the guiding objective for UNECE's work.

Carol Cosgrove-Sacks  
Maria Misovicova

*ANNEX I*

**PROGRAMME**  
**TRADE, BUSINESS AND INVESTMENT IN A WIDER**  
**EUROPE**

Palais des Nations, Geneva, 7 April 2003

**10:00 – 10:30      SESSION I**

**Chairman:** Mr. Dusan Sidjanski, President, Centre Européen de la Culture, Geneva

**Keynote Address: A wider Europe in the context of globalization and regionalism**

*Ms. Brigita Schmögnerová, Executive Secretary, United Nations Economic Commission for Europe (UNECE)*

**10:30 – 12:30      SESSION II: TRADE ISSUES IN A WIDER EUROPE**

**Chairman:** H.E. Mr. Carlo Trojan, Ambassador, Head of the Permanent Delegation of the European Commission, Geneva

**Trade between the EU and its near neighbours**

*Mr. Hiddo Houben, Deputy Head, Trade Analysis, Directorate-General for Trade, European Commission, Brussels*

**Regulatory convergence in a wider Europe**

*Mr. Constantin Stephanou, Department of International and European Studies, Panteion University, Athens, and Special Advisor for the Greek Presidency, Permanent Mission of Greece to the United Nations Office at Geneva*

**The enlarged EU and the non-acceding countries: the need for technical regulation and standards in the globalization**

*Mr. Nuno Encarnação, Moderator of the Telecom Initiative, UNECE Working Party 6, and Chairman of Access and Terminals, European Telecommunications Standards Institute, Expert of the Federal Office for Communications (Switzerland)*

**Doing business in emerging markets**

*Mr. Claude Cellich, Vice-President, International University in Geneva, and former Chief of Human Resource Development, International Trade Centre, UNCTAD/ WTO, Geneva*

**The social dimension of EU accession**

*Mr. Béla Galóczi, European Trade Union Confederation and European Trade Union Institute, Brussels*

**The challenge of enlargement for SMEs**

*Mr. Paul Dembinski, Secretary-General, Observatoire de la Finance, Geneva*

**12:30 – 13:00****PANEL DISCUSSION****13:00 – 15:00****LUNCH BREAK****15:00 – 17:30****SESSION III: BUSINESS AND INVESTMENT  
IN A WIDER EUROPE**

**Chairman:** Mr. Jean-Pierre Lehmann, International Institute for Management Development, Lausanne, Founding Director of the Evian Group

**EU near neighbours initiative**

*Mr. Gilbert Dubois, Head of Unit, OSCE and Council of Europe, Directorate-General for External Relations, European Commission, Brussels*

**The investment impact of EU enlargement on the non-acceding countries**

*Mr. David A. Dyker, Reader in Economics, University of Sussex, Brighton, United Kingdom*

**EU enlargement and the insurance markets in Eastern European candidate countries**

*Ms. Patrizia Baur, Economist, Swiss Reinsurance Company, Zürich*

**EU interests in the Caspian Sea Region including FDI and trade**

*Ms. Yelena Kalyuzhnova, Director of the Centre for Euro-Asian Studies, University of Reading, United Kingdom*

**Regional integration and governance issues**

*Ms. Brigid Gavin, United Nations University, Comparative Regional Integration Studies, Bruges, Belgium*

**Towards a Pan-European Economic Space**

*Mr. Ivan Samson, Russian-European Centre for Economic Policy, Moscow and University of Grenoble, France*

**Wider Europe and Ukraine's perspective**

*H.E. Mr. Mykhailo Skuratovskyi, Ambassador, Permanent Representative of Ukraine to the United Nations Office at Geneva*

**17:30 – 18:00**

**PANEL DISCUSSION**

**18:00**

**CLOSE OF THE MEETING**

**RECEPTION FOR THE PARTICIPANTS**

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ANNEX II

***EU AND WIDER EUROPE POLICY***

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The Communications from the European Commission on “Wider Europe – Neighbourhood: A New Framework for Relations with our Eastern” and “Southern Paving the Way for a New Neighbourhood Instrument” were reproduced from the official website of the European Commission at [http://europa.eu.int/comm/external\\_relations/we/doc/com03\\_104\\_en.pdf](http://europa.eu.int/comm/external_relations/we/doc/com03_104_en.pdf) and [http://europa.eu.int/comm/external\\_relations/we/doc/com03\\_393\\_en.pdf](http://europa.eu.int/comm/external_relations/we/doc/com03_393_en.pdf)

UNECE wishes to express its gratitude to the European Commission for these papers.

**COMMISSION OF THE EUROPEAN COMMUNITIES**

Brussels, 11.3.2003

COM (2003) 104 final

**COMMUNICATION FROM THE COMMISSION  
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT**

**Wider Europe — Neighbourhood: A New Framework for  
Relations with our Eastern and Southern Neighbours**

## List of abbreviations

Acquis	Acquis communautaire (Community legislation)
CEES	EU/Russia Common European Economic Space initiative
CFSP	EU Common Foreign and Security Policy
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
ERA	European Research Area
ESDP	EU European Security and Defence Policy
EU	European Union
FEMIP	Facility for Euro-Mediterranean Investment and Partnership
FTA	Free Trade Agreement
GDP	Gross Domestic Product
IFIs	International Financial Institutions
ILO	International Labour Organisation
INTERREG	Community programme aiming to stimulate inter-regional cooperation within the EU
JHA	Justice and Home Affairs
Meda	Community assistance programme for the Mediterranean countries
MFA	EU macro-financial assistance
NDEP	Northern Dimension Environmental Partnership
NIS	Newly Independent States (Armenia, Azerbaijan, Belarus, Georgia, Turkmenistan, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Ukraine, Uzbekistan)
OSCE	Organisation for Security and Cooperation in Europe
PCA	Partnership and Cooperation Agreement
Phare	Community assistance programme for the Central European candidate countries
PRINCE	Information Programme for European citizens
RTD	Research and Technological Development
Tacis	Community Technical Assistance programme for the Commonwealth of Independent States
TENs	Trans-European Networks
UN	United Nations
WNIS	Western Newly Independent States (Ukraine, Moldova, Belarus)
WTO	World Trade Organisation



## 1. Wider Europe: Accepting the Challenge

On 1 May 2004, the European Union will enter a new and historic phase. An enlarged Union of 25 countries, with a combined population of more than 450 million and GDP of almost €10000 billion, will fundamentally increase the political, geographic and economic weight of the EU on the European continent. Enlargement will boost EU growth and employment opportunities within a framework of shared values and common respect for fundamental liberties. New patterns in the movement of people, capital, goods and services will increase diversity in culture and traditions. Beyond the EU's borders, enlargement will change the shape of the EU's political and economic relations with other parts of the world.

Enlargement gives new impetus to the effort of drawing closer to the 385 million inhabitants of the countries who will find themselves on the external land and sea border, namely Russia, the Western NIS and the Southern Mediterranean<sup>1</sup>. The accession of the new member states will strengthen the Union's interest in enhancing relations with the new neighbours. Over the coming decade and beyond, the Union's capacity to provide security, stability and sustainable development to its citizens will no longer be distinguishable from its interest in close cooperation with the neighbours.

Interdependence – political and economic – with the Union's neighbourhood is already a reality. The emergence of the euro as a significant international currency has created new opportunities for intensified economic relations. Closer geographical proximity means the enlarged EU and the new neighbourhood will have an equal stake in furthering efforts to promote trans-national flows of trade and investment as well as even more important shared interests in working together to tackle trans-boundary threats - from terrorism to air-borne pollution. The neighbouring countries are the EU's essential partners: to

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<sup>1</sup> Southern Mediterranean: Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestinian Authority, Syria, Tunisia. Western Newly Independent States (WNIS): Ukraine, Moldova, Belarus.

increase our mutual production, economic growth and external trade, to create an enlarged area of political stability and functioning rule of law, and to foster the mutual exchange of human capital, ideas, knowledge and culture.

The EU has a duty, not only towards its citizens and those of the new member states, but also towards its present and future neighbours to ensure continuing social cohesion and economic dynamism. The EU must act to promote the regional and sub-regional cooperation and integration that are preconditions for political stability, economic development and the reduction of poverty and social divisions in our shared environment.

For the EU's part, the whole range of the Union's policies (foreign, security, trade, development, environment and others) will need to rise to meet this challenge. The November 2002 General Affairs and External Relations Council launched the work, noting in particular the situation of Ukraine, Moldova and Belarus – new neighbours on the Union's land border. The December 2002 Copenhagen European Council confirmed that the Union should take the opportunity offered by enlargement to enhance relations with its neighbours on the basis of shared values<sup>2</sup>. It repeated the Union's determination **to avoid drawing new dividing lines in Europe and to promote stability and prosperity within and beyond the new borders of the Union**. It reaffirmed that enlargement will serve to strengthen relations with **Russia**, and called for **enhanced relations with Ukraine, Moldova, Belarus and the Southern Mediterranean countries to be based on a long term approach promoting reform, sustainable development and trade**<sup>3</sup>. At the same time, the Council **reaffirmed the European perspective of the countries of the Western Balkans in the Stabilisation and Association Process**.

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<sup>2</sup> Notably democracy, respect for human rights and the rule of law, as set out within the EU in the Charter of Fundamental Rights.

<sup>3</sup> The European Parliament has also called for attention to be paid to the issues surrounding the new neighbours, most recently in its 12 February 2003 report on relations between the EU and Belarus.

This Communication considers how to strengthen the framework for the Union's relations with those neighbouring countries that do not currently have the perspective of membership of the EU<sup>4</sup>. It does not, therefore, apply to the Union's relations with the remaining candidate countries - Turkey, Romania and Bulgaria – or the Western Balkans. The Communication argues that enhanced interdependence – both political and economic – can itself be a means to promote stability, security and sustainable development both within and without the EU. The communication proposes that **the EU should aim to develop a zone of prosperity and a friendly neighbourhood – a 'ring of friends' - with whom the EU enjoys close, peaceful and co-operative relations.**

In return for concrete progress demonstrating shared values and effective implementation of political, economic and institutional reforms, including in aligning legislation with the *acquis*, the EU's neighbourhood should benefit from the prospect of closer economic integration with the EU. To this end, **Russia, the countries of the Western NIS and the Southern Mediterranean should be offered the prospect of a stake in the EU's Internal Market and further integration and liberalisation to promote the free movement of – persons, goods, services and capital (four freedoms).**

## **2. Neighbourhood – Different Countries, Common Interests**

The situations of Russia, the countries of the WNIS and the Southern Mediterranean are very different judged by most standards. The course of the 20<sup>th</sup> century saw dramatic changes in geography, politics and culture both on the European continent and in the Mediterranean. These forces have not necessarily led to greater convergence.

Differences are reflected in the variety and intensity of the Union's existing relations with and among the countries of its new neighbourhood. While, for example, the Union's relations with Belarus

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<sup>4</sup> Given their location, the Southern Caucasus therefore also fall outside the geographical scope of this initiative for the time being.

have progressed little since 1996, the development of EU/Russia dialogue and cooperation on political and security issues, energy, environment and science and technology over the past few years has accelerated rapidly. A new neighbourhood policy will only constitute one pillar of the overall EU/Russia strategic partnership.

### **Neighbourhood and EU Membership**

- Article 49 of the Treaty on European Union stipulates that any European state may apply to become a member of the European Union. Prospective candidates must meet the criteria for membership: democracy, the rule of law, human rights, respect for minorities; a functioning market economy, and the capacity to cope with competitive pressures; the ability to take on the obligations of membership (meaning to apply effectively the EU's rules and policies).
- The incentive for reform created by the prospect of membership has proved to be strong – enlargement has unarguably been the Union's most successful foreign policy instrument.
- In some cases the issue of prospective membership has already been resolved. Accession has been ruled out, for example, for the non-European Mediterranean partners. But other cases remain open, such as those European countries who have clearly expressed their wish to join the EU.
- In reality, however, any decision on further EU expansion awaits a debate on the ultimate geographic limits of the Union. This is a debate in which the current candidates must be in a position to play a full role.
- The aim of the new Neighbourhood Policy is therefore to provide a framework for the development of a new relationship which would not, in the medium-term, include a perspective of membership or a role in the Union's institutions. A response to the practical issues posed by proximity and neighbourhood should be seen as separate from the question of EU accession.

Regional trade and integration is a recognised objective of the EU's Mediterranean policy, not least because of the positive effects on regional political and economic stability that will result from the creation of a larger Mediterranean market. The EU has Free Trade Agreements (FTAs) in place with the countries of the Southern Mediterranean and the Barcelona process envisages that these should now be expanded to include the services sector as well as the goods sector more fully. Regional integration is also foreseen through the rapid negotiation and implementation of FTAs between the Mediterranean partners, as well as with the EU's customs union partner Turkey. While some Association Agreements with the EU still need to be ratified<sup>5</sup>, the Mediterranean partners are already being encouraged to approximate their legislation to that of the Internal Market.

In contrast to contractual relations with all the EU's other neighbouring countries, the Partnership and Cooperation Agreements (PCAs) in force with Russia, Ukraine and Moldova grant neither preferential treatment for trade, nor a timetable for regulatory approximation.

Given these different starting points and objectives it is clear that a new EU approach cannot be a one-size-fits-all policy. Different stages of reform and economic development also means that different rates of progress can be expected from the neighbouring countries over the coming decade.

On the other hand, it is increasingly clear that the EU shares an important set of mutual interests with each of its neighbours. All countries in the new neighbourhood are confronted by the opportunities and challenges surrounding **Proximity, Prosperity and Poverty**.

## Proximity

Geographical proximity presents opportunities and challenges for both the EU and for its neighbours. In the 1995 Barcelona Declaration, the

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<sup>5</sup> Association agreements with Tunisia, Israel, Morocco, Palestinian Authority and Jordan have entered into force. Those concluded with Egypt, Lebanon and Algeria await ratification. An association agreement with Syria is under negotiation.

EU and the Mediterranean partners recognised that geographical proximity increased the value of developing a comprehensive policy of close association, reflected in the negotiation of Association Agreements with each country. In the Partnership and Cooperation Agreements in effect with Russia, Ukraine and Moldova, the parties also agreed on the need to establish a strong partnership, based on historic links and common values. Both types of agreements were designed as instruments to help with the transition process, notably through gradual rapprochement between the EU and the partner countries and to create a wider area of cooperation.

More specifically, geographical proximity increases the importance of a set of issues revolving around, but not limited to, the management of the new external border and trans-boundary flows. The EU and the neighbours have a mutual interest in cooperating, both bilaterally and regionally, to ensure that their migration policies, customs procedures and frontier controls do not prevent or delay people or goods from crossing borders for legitimate purposes. Infrastructure, efficient border management and interconnected transport, energy and telecommunications networks will become more vital to expanding mutual trade and investment. Cross-border cultural links, not least between people of the same ethnic/cultural affinities, gain additional importance in the context of proximity. Equally, threats to mutual security, whether from the trans-border dimension of environmental and nuclear hazards, communicable diseases, illegal immigration, trafficking, organised crime or terrorist networks, will require joint approaches in order to be addressed comprehensively.

### **Prosperity and Poverty**

A new EU approach to its neighbouring countries cannot be confined to the border regions alone. If the EU is to work with its neighbourhood to create an area of shared prosperity and stability, proximity policy must go hand-in-hand with action to tackle the root causes of the political

instability, economic vulnerability, institutional deficiencies, conflict and poverty and social exclusion<sup>6</sup>.

Most of the EU's Southern and Eastern neighbours have a nominal GDP per capita of less than €2000<sup>7</sup>. Poverty and social exclusion has increased sharply in Russia and the WNIS over the past decade as a result of falling output and increased inequality in the distribution of income. This has led to an increased risk of social and political dislocation. In Russia, GDP is still a third lower than its level in 1989; Moldova remains at below half of its former level of GDP. What is perhaps less known is that the Mediterranean has also had a very poor rate of growth in GDP per capita. Egypt, Israel and Tunisia are the only countries to have exceeded 2% growth since 1975, while Algeria, for example, shows a small negative growth rate. Only sub-Saharan Africa shows a worse overall growth rate than these two regions. Moldova is by far the poorest neighbouring country (€417 per capita<sup>8</sup>), Ukraine the next most poor (€855). Israel is the richest of the EU's neighbours (€19578), with Lebanon (€5284) second richest, albeit at a considerably lower level of GDP, and Russia some way behind both countries (€2382). A cluster of countries – Belarus, Egypt, Morocco, West Bank/Gaza and Syria – has achieved between three and four times the level of Moldovan GDP per capita (€1292 - €1663).

Despite the sluggish rate of economic growth, the Mediterranean region has long been characterised by a low level of absolute poverty<sup>9</sup>. Relative poverty is, however, an issue as nearly 30% of the population live on less than \$2 a day and illiteracy rates remain high. Only 0.6% of population use the Internet and only 1.2% have access to a computer<sup>10</sup>.

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<sup>6</sup> As set out in the 10 November 2000 Council/Commission Statement on EU Development Policy.

<sup>7</sup> See Annex for statistics on GDP, trade and investment, migration and assistance.

<sup>8</sup> Nominal estimates for 2001, EBRD Transition Report update, 2002.

<sup>9</sup> Individuals earning less than \$1 per day, measured in purchasing power parity terms.

<sup>10</sup> UNDP Arab Human Development Report.

In Russia and the WNIS, poverty rates have increased considerably since 1990. Russia has seen some reversal of this trend in recent years.

Democracy, pluralism, respect for human rights, civil liberties, the rule of law and core labour standards are all essential prerequisites for political stability, as well as for peaceful and sustained social and economic development. Nearly all countries of the Mediterranean, the WNIS and Russia have a history of autocratic and non-democratic governance and poor records in protecting human rights and freedom of the individual. Generally, the countries of the WNIS and Russia have taken steps towards establishing democracy and market institutions over the past 12 years. Yet political reform in the majority of the countries of the Mediterranean has not progressed as quickly as desired.

Trade and investment are vital to improving economic growth and employment. Ensuring secure and sustainable energy supplies will call for additional, vast investments in Russia, the WNIS and the Mediterranean. At the same time, economic diversification towards labour-intensive, employment-creating industries and services are urgently needed, not only in relatively resource-poor countries, such as Ukraine, Moldova and Morocco, but also in energy-rich countries, such as Algeria and Russia. Energy dominates imports from both regions, more so for trade with Russia than from the WNIS and the Southern Mediterranean, where textiles and agricultural produce represent a considerable share of imports from certain countries (Moldova, Morocco, Tunisia). In 2001, a year with high oil prices, exports to the EU from Russia and the WNIS, and the Southern Mediterranean amounted to approximately €60 billion for each of the two regions, while imports from the EU were only just over half the exports for both. To compare, in 2001 Hungarian imports and exports to the EU alone totalled around €25 billion each way. The neighbouring countries all face weak levels of foreign direct investment when compared with countries at similar levels of development and relative to their needs. For example, per capita foreign investment in Russia is less than one sixth of the level in Poland, in addition to which Russia has seen an average annual domestic capital flight of \$20 billion over the last 10 years.



### **Promoting Regional and Intra-Regional Cooperation**

- The Euro-Mediterranean partnership offers a strong policy framework for the EU's relations with Mediterranean countries. Since the Barcelona declaration was adopted in 1995 it has formed the basis for a continuing dialogue and cooperation in spite of the political turmoil in the region.
- As far as the bilateral dimension of EU relations is concerned, the basic framework is similar for both groups of countries: Association Agreements or Partnership and Cooperation agreements, including political dialogue, are accompanied by national Meda/Tacis programmes and agreements on specific issues (readmission, fisheries etc.). The most important difference is that, in the Mediterranean, an explicit regional dimension encouraging the development of intra-regional initiatives and cooperation in a broad range of sectors is included. This policy of promoting intra-regional cooperation consists of three Chapters defined in the Barcelona Declaration supplementing the bilateral framework: the Political and Security Chapter, Economic and Financial Chapter and Social, Cultural and Human Chapter. Since 1995, seven meetings of the Foreign Ministers of the 15+12 have taken place, together with 16 meetings of sectoral ministers. These meetings have launched a number of joint cooperation initiatives, financed through the Meda regional programme.
- On the future Eastern external border, regional economic cooperation among the WNIS is already quite strong, oriented around traditional flows of trade and investment to and from Russia. However, encouragement for regional political cooperation and/or economic integration has not so far formed a strong component of EU policy towards Russia and the WNIS.
- The Northern Dimension currently provides the only regional framework in which the EU participates with its Eastern

partners to address trans-national and cross-border issues. But participation is restricted to Russia.

- In the context of a new EU neighbourhood policy, further regional and sub-regional cooperation and integration amongst the countries of the Southern Mediterranean will be strongly encouraged. New initiatives to encourage regional cooperation between Russia and the countries of the Western NIS might also be considered. These could draw upon the Northern Dimension concept to take a broader and more inclusive approach to dealing with neighbourhood issues.

Spreading the benefits of increased economic growth to all sectors of society requires positive action to promote social inclusion via mutually reinforcing economic, employment and social policies. Attention to areas including education, health, training and housing is equally important. Increasing environmental and economic efficiency should also proceed hand-in-hand. Serious environmental pollution and deficiencies in managing nuclear and toxic waste affect public health and living standards in many of the neighbouring countries and contribute to shortening life expectancy in some. At the same time, the wasteful and inefficient use of natural resources reduces present and, crucially, future prospects for economic growth.

A functioning legal system, implemented by strong regulatory authorities and effective and independent judiciaries equipped with the powers to protect property rights, are also required to maximise economic activity and production, and accelerate economic growth.

The negative effects of conflict on economic and political development, especially where sustained over a long period, cannot be over-estimated. These effects are not only domestic – so long as conflicts persist there is a danger of spill over. Conflict and political division in the Mediterranean (Western Sahara, Palestine) over the past half century has seriously retarded the development of the region. Unrecognised statelets such as Transdnistria are a magnet for organised crime and can de-stabilise or throw off course the process of state-building, political consolidation and sustainable development.

**The EU has a clear interest in ensuring that these common challenges are addressed.**

### **3. A New Vision and A New Offer**

The EU can and should work to spread the benefits of enlargement for political and economic stability in the neighbouring countries and to help reduce prosperity gaps where they exist. This should be reflected in a **clear vision** for the development of closer and more coherent relations with the Union's neighbours over the medium and long term. The EU should act to reinforce and unite its existing neighbourhood policy towards these regions around two overarching objectives for the next decade or longer:

- To work with the partners to reduce poverty and create an area of shared prosperity and values based on deeper economic integration, intensified political and cultural relations, enhanced cross-border cooperation and shared responsibility for conflict prevention between the EU and its neighbours.
- To anchor the EU's offer of concrete benefits and preferential relations within a differentiated framework which responds to progress made by the partner countries in political and economic reform.

The establishment at pan-European level of an open and integrated market functioning on the basis of compatible or harmonised rules and further liberalisation would bring significant economic and other benefits to both the EU and the neighbourhood. A political, regulatory and trading framework, which enhances economic stability and institutionalises the rule of law, will increase our neighbours' attractiveness to investors and reduce their vulnerability to external shocks. Further reciprocal market access through preferential agreements covering goods and services will have the greatest positive impact if accompanied by measures to facilitate economic activity. Sustainable development requires a common understanding that the adoption of a broader range of policies, including environmental protection, will support more rapid economic growth. Research and scientific **cooperation** can catalyse technological progress. The EU *acquis* offers a well established model on which to establish functioning

markets and common standards for industrial products, services, transport, energy and telecommunications networks, environmental and consumer protection, health, labour and minimum quality requirements. Enhanced and better targeted EU development assistance could accompany reform, helping to build administrative capacity and mitigate social adjustment costs.

In return for concrete progress demonstrating shared values and effective implementation of political, economic and institutional reforms, including aligning legislation with the *acquis*, the EU's neighbourhood should benefit from the prospect of closer economic integration with the EU. Specifically, **all the neighbouring countries should be offered the prospect of a stake in the EU's Internal Market and further integration and liberalisation to promote the free movement of – persons, goods, services and capital (four freedoms)**. If a country has reached this level, it has come as close to the Union as it can be without being a member.<sup>11</sup> The EU therefore should stand ready to work in close partnership with the neighbouring countries who wish to implement further reforms and assist in building their capacity to align with and implement parts of the *acquis communautaire*.

The EU's approach could therefore be based on the following incentives:

□ **Extension of the Internal Market and Regulatory Structures:** Common rules and standards are vital to ensure that our neighbours can access and reap the benefits of the enlarged EU internal market as well as to create a more stable environment for economic activity. The EU *acquis*, which has established a common market based on the free movement of goods, persons, services and capital, ensuring competition and a level playing field based on shared norms and integrating health, consumer and environmental protection, could serve as a model for countries undertaking institutional and economic reform.

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<sup>11</sup> President Prodi's speech to the Sixth ECSA-World Conference, Brussels, 5-6 December 2002.

Both the Association and Partnership and Cooperation Agreements set, in broad terms, an agenda for legislative and regulatory approximation, albeit without fixed deadlines. For the WNIS, this agenda could be developed as currently explored in the Common European Economic Space (CEES) initiative launched with Russia. The CEES itself should be developed to set out a deeper and broader timetable for legislative approximation between the EU and Russia. Participation in selected EU activities and programmes, including aspects such as consumer protection, standards, environmental and research bodies, could be opened to all neighbouring countries. Efforts to support the further development of enterprise policy by the partner countries should accompany regulatory approximation.

□ **Preferential Trading relations and Market Opening:** Although countries can benefit from approximating their economic rules and structures on those of the EU before proceeding with trade liberalisation, more open trade is a key component for market integration.

As provided for in the Barcelona process, the free trade agreements that are already in place with the Mediterranean countries should cover more fully the goods and services sectors. Creating a more integrated market requires that our partners also conclude agreements of a similar depth among themselves, as well as with Turkey. For Russia and the WNIS, Free Trade Areas are envisaged in the PCAs, but with no timetable attached. Objectives and benchmarks could be developed. The sequencing of economic rapprochement is important to ensure that liberalisation really helps development. For Moldova which does not currently possess the competitive strength or administrative capacity to take on the reciprocal obligations of an FTA yet, the EU is ready to consider developing new initiatives to grant better market access, in line with WTO obligations.

□ **Perspectives for Lawful Migration and Movement of Persons:** The EU and the partner countries have a common interest in ensuring the new external border is not a barrier to trade, social and cultural interchange or regional cooperation. The impact of ageing and demographic decline, globalisation and specialisation means the EU and

its neighbours can profit from putting in place mechanisms that allow workers to move from one territory to another where skills are needed most – although the free movement of people and labour remains the long-term objective. Significant additional opportunities for cultural and technical interchange could be facilitated by a long-stay visa policy on the part of the EU member states.

An efficient and user-friendly system for small border traffic is an essential part of any regional development policy. The EU is currently looking at ways of facilitating the crossing of external borders for *bona fide* third-country nationals living in the border areas that have legitimate and valid grounds for regularly crossing the border and do not pose any security threat. The EU could also consider the possibilities for facilitating the movement of citizens of neighbouring countries participating in EU programmes and activities. EU member states should also consider using the possibilities for granting visa-free access to holders of diplomatic and service passports. Beyond this, provided the necessary conditions are in place, the EU should be open to examine wider application of visa free regimes. The EU should develop a common approach to ensure the integration of third country nationals, with special emphasis on citizens of the neighbouring countries lawfully resident in the Union. The EU should assist in reinforcing the neighbouring countries' efforts to combat illegal migration and to establish efficient mechanisms for returns, especially illegal transit migration. Concluding readmission agreement with all the neighbours, starting with Morocco, Russia, Algeria, Ukraine, Belarus and Moldova, will be an essential element in joint efforts to curb illegal migration.

□ **Intensified Cooperation to Prevent and Combat Common Security Threats:** Cooperation, joint work and assistance to combat security threats such as terrorism and trans-national organised crime, customs and taxation fraud, nuclear and environmental hazards and communicable diseases should be prioritised.

Both domestic measures and intensified bilateral and multilateral action are indispensable to fight organised crime. Particular attention should be paid to drugs trafficking, trafficking in human beings, smuggling of migrants, fraud, counterfeiting, money laundering and corruption. The

EU should explore the possibilities for working ever more closely with the neighbouring countries on judicial and police cooperation and the development of mutual legal assistance. The approach taken in the EU/Russia Action Plan against organised crime and the Justice and Home Affairs (JHA) Action Plan for Ukraine, which includes a scoreboard, could be developed for other neighbouring countries. The EU should capitalise on the cooperation initiated in the Mediterranean to introduce reforms to the judicial system, improve police training and other cooperation in the fight against organised crime. The fight against terrorism is a potential area for closer cooperation. The new neighbours should also be assisted in the implementation of all the relevant international instruments in this field, notably those developed in the UN. EU political focus and assistance must continue to support efforts to take forward nuclear clean-up in north west Russia and follow-up to the closure of the Chernobyl Nuclear Power Plant. Efforts to combat trans-boundary pollution - air, sea, water or land - should be modelled on the collaborative approach taken by the Northern Dimension Environmental Partnership (NDEP) and the Danube-Black Sea Task Force.

❑ **Greater EU Political Involvement in Conflict Prevention and Crisis Management:** Shared values, strong democratic institutions and a common understanding of the need to institutionalise respect for human rights will open the way for closer and more open dialogue on the Union's Common Foreign and Security Policy (CFSP) and the development of the European Security and Defence Policy (ESDP). A shared neighbourhood implies burden-sharing and joint responsibility for addressing the threats to stability created by conflict and insecurity.

The EU should take a more active role to facilitate settlement of the disputes over Palestine, the Western Sahara and Transdniestria (in support of the efforts of the OSCE and other mediators). Greater EU involvement in crisis management in response to specific regional threats would be a tangible demonstration of the EU's willingness to assume a greater share of the burden of conflict resolution in the neighbouring countries. Once settlement has been reached, EU civil and crisis management capabilities could also be engaged in post-conflict

internal security arrangements. Additional sources of funding for post-conflict reconstruction and development would be required.

□ **Greater Efforts to Promote Human Rights, Further Cultural Cooperation and Enhance Mutual Understanding:** Shared values and mutual understanding provide the foundations for, inter alia, deeper political relations, enhanced cooperation on justice and security issues, environmental improvement and governance. The importance of dialogue between civilisations and the free exchange of ideas between cultures, religions, traditions and human links cannot be over-emphasised. The EU should contribute to the development of a flourishing civil society to promote basic liberties such as freedom of expression and association. The EU also needs to make a greater effort to create a positive image in the neighbourhood and act to combat stereotypes which affect perceptions of the neighbouring countries within the EU.

EU programmes and activities in research, education, culture and bilateral visitor programmes should be expanded. Exchange programmes between youth and universities, the creation of European studies courses and the opening of new Euro-information centres, 'people-to-people' activities, including professional exchange/visit programmes, activities in the field of media, training and journalists exchanges merit close consideration. Ideas circulated by the new member states should be looked upon favourably. Exchanges on a regional level regarding governance and human rights training issues have proven beneficial and should be explored further. In the Mediterranean, work could take place under the auspices of the Euro-Mediterranean Foundation. Attention should be given to strengthening EU information policy in Russia and the WNIS in cooperation with the member states. Twinning opportunities between local government and civil society organisations and judicial cooperation should be fully utilised. A PRINCE information campaign to make the European public aware of the benefits and challenges of the wider Europe framework will be launched.



□ **Integration into Transport, Energy and Telecommunications Networks and the European Research Area:**

Full integration into EU markets and society requires compatible and interconnected infrastructure and networks as well as harmonised regulatory environments. EU policies such as Trans-European Networks (TENs), Galileo and other research activities should draw up strategies for the Eastern and Southern neighbours.

The Meda regional programme is producing blueprints for infrastructure interconnection and regulatory approximation and harmonisation in transport, energy and telecommunications (Trans-Euro-Mediterranean Networks). These blueprints should be implemented with loans and risk capital from the EIB through the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) as well as the other International Financial Institutions (IFIs). The EU should encourage and support telecommunications markets in the neighbouring countries, improving the availability of Internet access for business and private use and encouraging the growth of knowledge-based economies. As set out in the 6<sup>th</sup> Framework programme for Research and Technological Development (RTD), the EU should take forward the opening of the European Research Area (ERA) to integrate the scientific communities of the neighbouring countries, exploit scientific results, stimulate innovation and develop human resources and research capacities.

□ **New Instruments for Investment Promotion and Protection:**

A stronger and more stable climate for domestic and foreign investment is critical to reducing the wealth gap that exists between the EU and its neighbours. Foreign investment can encourage reform and improved governance at the same time as contributing to the transfer of know-how and management techniques and the training of local personnel.

Future agreements concluded with our neighbours could include reciprocal provisions granting companies national treatment for their operations as well to strengthen the overall framework to protect investment. The EU should continue to assist the fight against corruption, strengthening of the rule of law and the independence of the judiciary. The EU should help to enhance business-to-business dialogue initiatives, involving EU and the neighbours' companies. The EU-

Russia Industrialists Round Table process and the Business Summits with the Mediterranean countries have been useful instruments for entrepreneurs to develop practical suggestions on how to improve the investment and business climate in the neighbouring countries. Regional bodies representing entrepreneurs and EU business associations in the neighbouring countries are valuable partners in this area.

❑ **Support for Integration into the Global Trading System:** WTO Membership is an integral part of a positive economic agenda and expanding trade and investment links.

The EU should support a high rhythm of WTO negotiations with the applicant countries - Russia, Ukraine, Algeria, Lebanon and Syria – and continue to offer assistance to prepare for accession on acceptable terms as soon as possible. The Tacis and Meda programmes could provide further trade-related technical assistance and training for customs cooperation and trade facilitation, intellectual property rights, regulation of the service sector and the approximation and implementation of Internal Market legislation.

❑ **Enhanced Assistance, Better Tailored to Needs:** Proximity calls for further efforts to encourage cross-border and trans-national cooperation and development, both locally and regionally. This includes the strengthening of all forms of economic, legal and social cooperation across the borders, especially between regional and local authorities and within civil society. The EU should work with the neighbours to facilitate common management of migration flows and border transit and to address trans-border organised crime, including illicit trafficking, as well as corruption, fraud, environmental, nuclear issues and communicable diseases. The EU's cooperation instruments must be sufficiently flexible to address the entire range of needs.

For Russia and the WNIS, constraints on coordination between the existing EU instruments create obstacles to cross-border and sub-regional activities. Taking into account the constraints that may arise in the short-term, the Commission will consider the possibility of creating

a new Neighbourhood Instrument which builds on the positive experiences of promoting cross-border cooperation within the Phare, Tacis and INTERREG programmes<sup>12</sup>. This instrument will focus on trans-border issues, promoting regional and sub-regional cooperation and sustainable development on the Eastern border. For the Mediterranean, consideration should be given to whether such a unified proximity instrument could also apply to shorter sea crossings (between the enlarged EU and a number of Barcelona partner countries). The EU should accompany progress made in reforms with enhanced assistance to mitigate the impact of adjustment on the poor and vulnerable. The WNIS should benefit from more direct grant aid and budget support for tackling poverty, social and economic inequality and exclusion to achieve greater social cohesion. Criteria for eligibility for EU exceptional macro-financial assistance (MFA) should be clarified. The need for a MFA framework regulation could be re-assessed.

❑ **New Sources of Finance:** EU technical and grant assistance is not the only means for promoting reform or catalysing private investment. The IFIs have a key role to play in reducing poverty, helping to mitigate the social consequences of transition, assisting accelerated reform and increased investment as well as developing infrastructure and the private sector.

Community financial instruments and the EIB should continue to support infrastructure investment in the Mediterranean. FEMIP or, subject to Council review, a possible Euro-Med bank, are means of providing additional support for private sector development in the region. For Russia and the WNIS, community, EBRD and EIB supported initiatives should be further developed. While the central role played by the EBRD should continue to be supported, the EU could also consider the progressive and targeted increase of EIB lending to Russia, and its extension to Ukraine, Moldova and, eventually, Belarus. The EU should ensure the IFIs take adequate account of the importance of

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<sup>12</sup> Although outside the geographical scope of this paper, similar considerations apply to cross border aspects of the CARDS programme in the Western Balkans.

spending on education, health and social safety net provisions in their policies towards the neighbouring countries.

#### **4. A Differentiated, Progressive, and Benchmarked Approach**

The long term goal of the initiatives set out in Chapter 3 is to move towards an arrangement whereby the Union's relations with the neighbouring countries ultimately resemble the close political and economic links currently enjoyed with the European Economic Area. This implies the partners taking on considerably deeper and broader obligations, specifically when it comes to aligning with Community legislation. However, the new neighbourhood policy should not override the existing framework for EU relations with Russia and the countries of the Western NIS, and the Southern Mediterranean. Instead, it would supplement and build on existing policies and arrangements.

##### **Belarus**

- EU-Belarus relations stalled in 1996-7 as a consequence of serious setbacks in the development of democracy and human rights in Belarus, in particular the replacement of the democratically elected parliament with a national assembly nominated by the President in violation of the 1994 constitution.
- The GAC reacted in 1997 by freezing conclusion of the PCA, signed in 1995, and restricting ministerial level contacts and the scope of EU assistance to Belarus.
- Despite repeated approaches by the EU, OSCE and Council of Europe since 1997, Belarus has applied a constant policy of deviation from its commitments to the Council of Europe and OSCE. Confrontation with the OSCE over its representation in Minsk led to a decision of 14 member states to impose a visa ban on government representatives in November 2002.
- The EU faces a choice in Belarus: either to leave things to drift – a policy for which the people of Belarus may pay dear and one which prevents the EU from pursuing increased

cooperation on issues of mutual interest - or to engage, and risk sending a signal of support for policies which do not conform to EU values.

- In the run-up to the parliamentary elections in 2004, the EU should aim to engage Belarus in a measurable, step-by-step process focused on creating the conditions for free and fair elections and, once achieved, the integration of Belarus into the neighbourhood policy, without compromising the EU's commitment to common and democratic values.

As noted above, the neighbouring countries do not start from the same point in their relations with the EU. Some partners already have FTAs with differing degrees of scope and depth; others have begun the process of developing a strategic partnership with the EU, with economic integration with the EU as one aspect of this. While the EU should aim to ensure a more coherent approach, offering the same opportunities across the wider neighbourhood, and asking in return the same standards of behaviour from each of our neighbours, **differentiation** between countries would remain the basis for the new neighbourhood policy.

The overall goal will be to work with partner countries to foster the political and economic reform process, promote closer economic integration and sustainable development and provide political support and assistance. The EU should start from the premise that the institutions of state need to be capable of delivering full transition to comply with international political, legal and human rights standards and obligations. Partners will start from variable, in some cases limited, capacity to undertake rapid reform and comprehensive transition. They will need to show a strong commitment to building up their administrative, institutional and legal capacity. There is therefore no alternative to a step-by-step approach. The extension of the benefits set out in Chapter 3, including increased financial assistance, should be conducted so as to encourage and reward reform – reforms which existing EU policies and incentives have so far not managed to elicit in all cases. Engagement should therefore be introduced **progressively**, and be **conditional on meeting agreed targets for reform**. New

benefits should only be offered to reflect the progress made by the partner countries in political and economic reform. In the absence of progress, partners will not be offered these opportunities.

This communication proposes that the principles of differentiation and progressivity should be established by means of country and/or regional **Action Plans**. These should be political documents – drawing together existing and future work in the full range of the EU’s relations with its neighbours, in order to set out clearly the over-arching strategic policy targets and benchmarks by which progress can be judged over several years. They should be concise, complemented where necessary by more detailed plans for sector-specific cooperation.

The setting of clear and public objectives and **benchmarks** spelling out the actions the EU expects of its partners is a means to ensure a consistent and credible approach between countries. Benchmarks also offer greater predictability and certainty for the partner countries than traditional ‘conditionality’. Political and economic benchmarks could be used to evaluate progress in key areas of reform and against agreed targets. Beyond the regulatory and administrative aspects directly linked to market integration, key benchmarks should include the ratification and implementation of international commitments which demonstrate respect for shared values, in particular the values codified in the UN Human Rights Declaration, the OSCE and Council of Europe standards. Wherever possible, these benchmarks should be developed in close cooperation with the partner countries themselves, in order to ensure national ownership and commitment.

International organisations, notably the OSCE and the Council of Europe, the International Labour Organisation (ILO) and the IFIs, can assist with establishing benchmarks. These organisations should also be engaged in the process of supporting related reforms.

Action Plans and accompanying benchmarks should be established by the Council, based on proposals from the Commission, wherever possible with prior discussion with the partner countries concerned. The Action Plans, once agreed, will supersede common strategies to become the Union’s main policy document for relations with these countries over the medium term.

When it comes to the **institutional and contractual arrangements** of the Association Agreements and Partnership and Cooperation Agreements, the full implementation and exploitation of the provisions contained in the existing Agreements remains a necessary precondition for any new development.

### Libya

- The EU has no contractual relations with Libya.
- In April 1999, following the suspension of UN sanctions, Libya acquired observer status in the Barcelona Process and was invited to become a full member as soon as the UN Security Council sanctions have been definitively lifted and once Libya has accepted the full Barcelona 'acquis'.
- The EU has suspended sanctions against Libya and lifted restrictions on diplomatic and consular personnel and visas; the embargo on arms exports remains in place.
- Although Libya has not so far accepted the Barcelona acquis, in particular because of disagreement over the position of Israel and the Palestinian Authority, it regularly observes in Foreign Ministers and Senior Official's meetings.
- The EU should therefore give consideration to how it could incorporate Libya into the neighbourhood policy. In order to send a coherent message, further engagement needs to be pursued within a conditional framework and a clear understanding of the benefits of making progress towards cooperation based on respect for shared values.

Thereafter, the EU will examine the scope for new **Neighbourhood Agreements** to build on existing contractual relations. These would supplement existing contractual relations where the EU and the neighbouring country have moved beyond the existing framework, taking on new entitlements and obligations. If, however, the Neighbourhood Agreements contain provisions going beyond those of

the Euro-Mediterranean Association Agreements, similar arrangements could be offered, on equivalent terms, to the Mediterranean partners.

## 5. Next Steps

A three step process could be envisaged for developing and implementing the Action Plans for each country:

- I. Dialogue in the existing frameworks (Association and Partnership and Cooperation Agreements) jointly analysing the achievements and failures of reform hitherto. The Association and Cooperation Committees should be mandated to prepare this work.
- II. A document would then be drawn up by the Commission and the Member States, to be agreed in association with each country, setting out common objectives and benchmarks and a timetable for their achievement. This action plan should be given a political endorsement by the EU and the partner(s) involved, if appropriate at the level of the Association and Cooperation Councils.
- III. An annual review of progress in implementing the Action Plan, integrated into the existing institutional cooperation framework with the partner countries, would be a concrete demonstration of enhanced EU political interest and provide governments with the opportunity to receive credit from the EU for their political and economic reform efforts.

The financial implications of the new Neighbourhood Policy should be reflected in the Commission's future budgetary proposals. The Commission will consider proposals for a new Neighbourhood Instrument focussing on ensuring the smooth functioning and secure management of the future Eastern and Mediterranean borders, promoting sustainable economic and social development of the bordering regions and pursuing regional and trans-national cooperation. The Commission will consider how objectives and benchmarks could help regarding regulatory approximation, further market opening and preferential trade relations with Russia, Ukraine and Moldova in line with the commitments and obligations in the PCAs. Where justified by



progress made against the Action Plans, the Commission will also put forward initiatives to:

- extend existing Community policies, programmes and instruments to neighbouring countries not already benefiting from them.
- implement a progressive and targeted extension of the EIB's external mandate to Russia and the WNIS, in close collaboration with the EBRD and the other relevant IFIs.
- evaluate FEMIP and consider its possible incorporation into an EIB majority owned Euro-Med Bank.

The contribution of the new member states will be fundamental to the development of the new neighbourhood policy.

**ANNEX: Tables and Charts****Table 1: Basic economic indicators**

	Population	GDP	Overall	Overall	Imports from	Exports to	FDI
	in million	per capita in EUR	Imports EURmillion	Exports EURmillion	the EU EURmillion	the EU EURmillion	EURmillion
Israel	6.4	19 578	36721	32 032	15 557	8 544	3 397
Algeria	30.7	1 974	12882	21 788	8 234	14 473	1 335
Egypt	65.3	1 663	14063	4 614	4 191	1 453	569
Libya	5.4	1776 <sup>(1)</sup>	4867	12 548	3 247	10 331	- 112
Morocco	29.2	1 296	12192	7 945	6 302	5 562	2 966
Tunisia	9.7	2 301	10622	7 379	7 563	5 892	543
Jordan	5.2	1 901	5344	2 553	1 535	98	189 <sup>(2)</sup>
Lebanon	3.6	5 284	7072	1 030	3 366	274	278 <sup>(2)</sup>
Occ. Palest. Terr.	3.0	1591 <sup>(1)</sup>	3339(1)	653 <sup>(1)</sup>	31 <sup>(3)</sup>	6 <sup>(3)</sup>	57 <sup>(2)</sup>
Syria	17.1	1 292	6970	6 121	2 287	3 747	229 <sup>(2)</sup>
Belarus	10.0	1 352	8966	8 286	1 387	917	189
Moldova	4.3	417 <sup>(1)</sup>	998	636	278	136	167
Russian Fed.	144.8	2 382	41006	91 864	16 597	35 703	2 835
Ukraine	49.1	855	18665	16 139	5 437	3 316	862

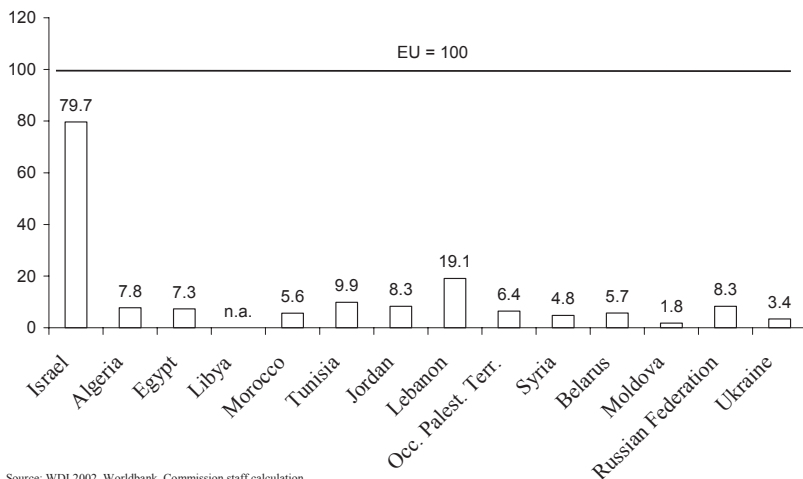
Source: WDI 2002 (World Bank), IMF (GDP per capita), IMF (trade data), EU, UNCTAD/DITE for FDI data. Data refers to 2001.

<sup>(1)</sup> 2000 data

<sup>(2)</sup> estimates

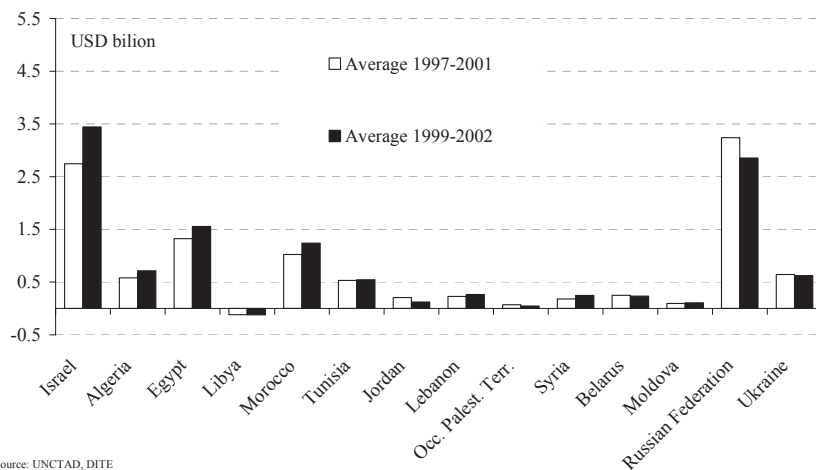
<sup>(3)</sup> Inversion of data reported by EU

**Chart 1: GDP per capita in % of EU**



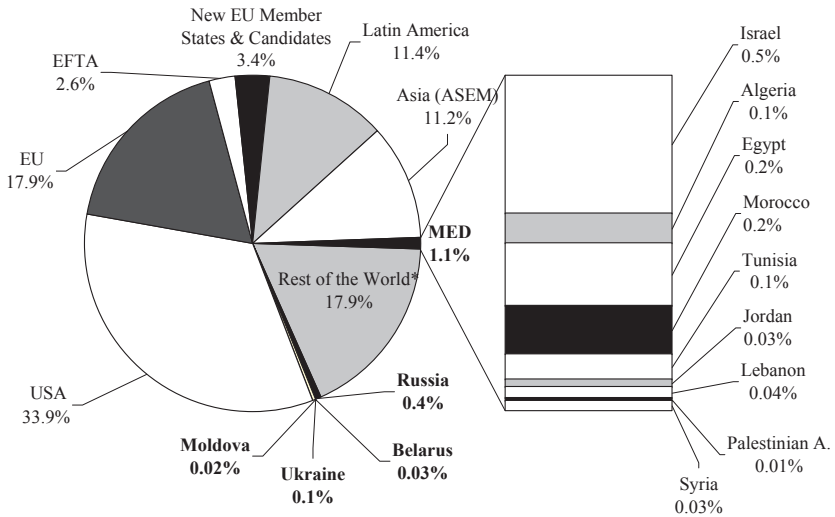
Source: WDI 2002, Worldbank, Commission staff calculation

**Chart 2: Total FDI flows**

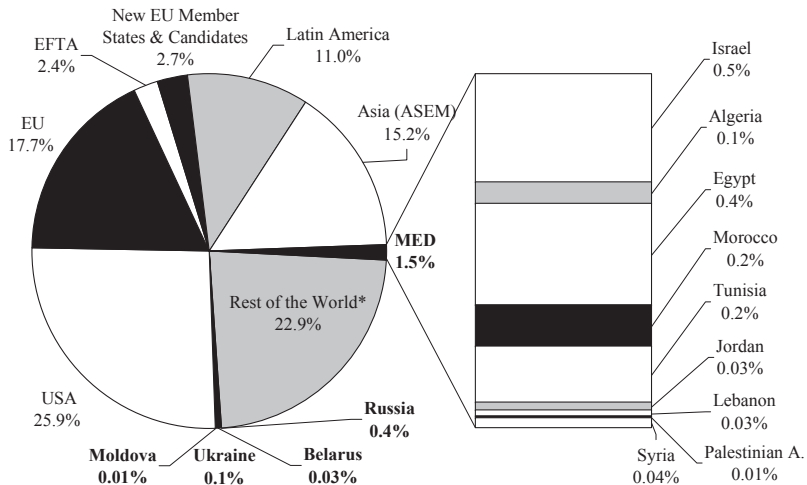


Source: UNCTAD, DITE

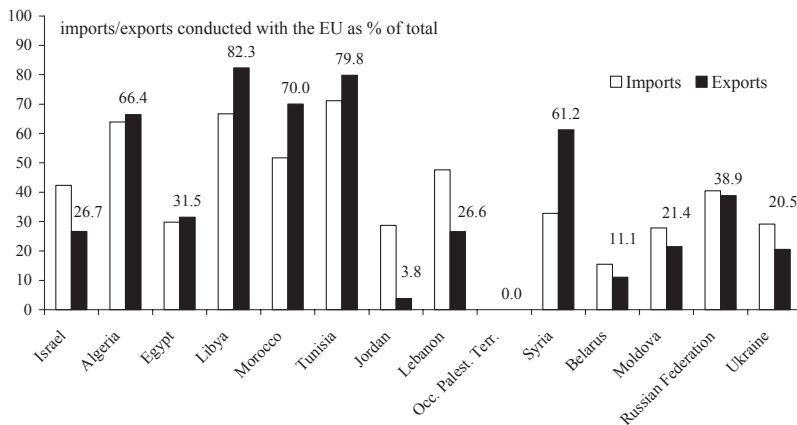
**Chart 3: Share of World Foreign Investment Inflows (Average 1998-2001)**



**Chart 4: Share of World Inward Foreign Investment Stock (2001)**

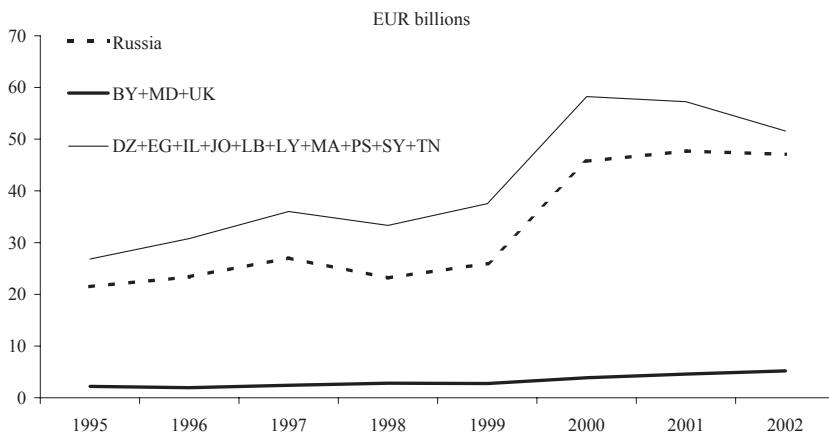


**Chart 5: Trade integration with the EU**



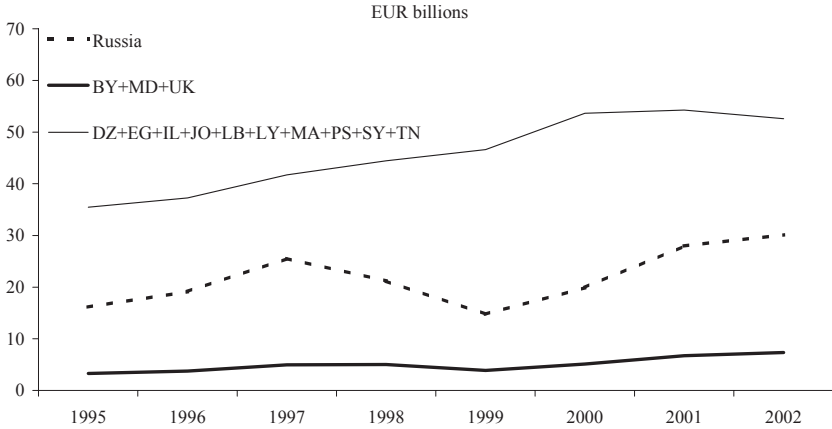
Source: DOTS (IMF)

**Chart 6: Exports to EU-15**



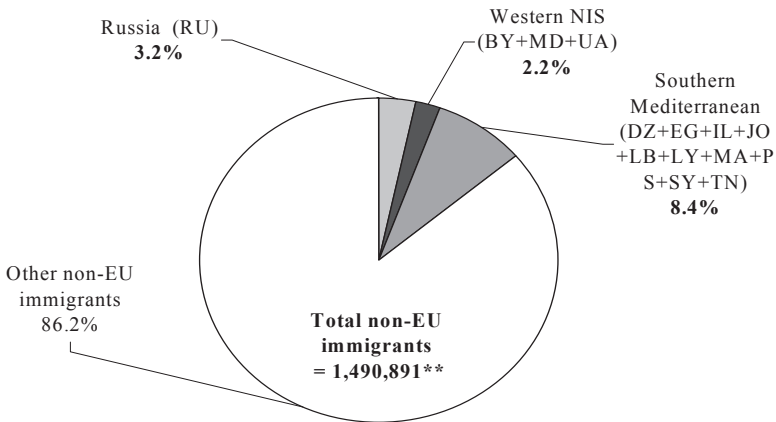
Source: Eurostat, COMEXT

**Chart 7: Imports from EU-15**



Source: Eurostat, COMEXT

**Chart 8: Immigration of South. Mediterranean, Western NIS, and Russian nationals to the EU-15 as percentages of all non-EU immigrants, 2000\***



\*Source: Eurostat. 1999 data: B, D, F, I. 1998 data: EL

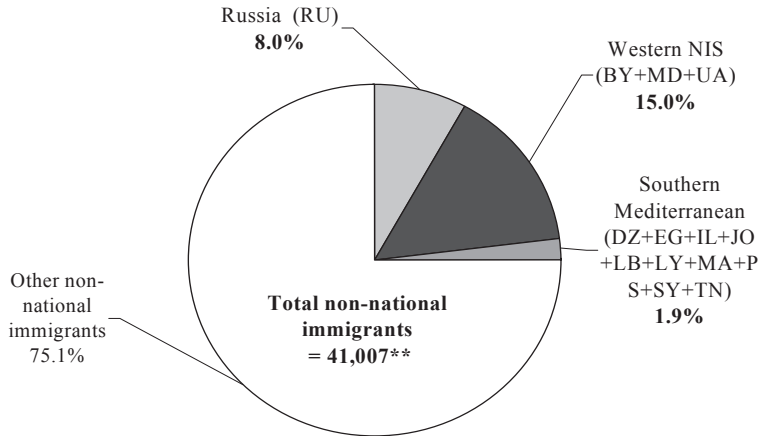
\*\*Includes non-EU immigrants into IRL but nationality-specific details for Eastern and Southern countries are not available.

**Table 2: Population - Growth rates**

	Population				Population growth rates	
	1990	1995	2000	<u>2001</u>	2001	<u>Avg. 1995 -2000</u>
	in million	in million	in million	in million	in %	in %
Israel	4.7	5.5	6.3	6.4	2.4	2.5
Algeria	25.0	28.1	30.3	30.7	1.5	1.5
Egypt	51.9	57.5	64.0	65.3	2.1	2.1
Libya	n.a.	4.8	5.3	5.4	2.3	2.2
Morocco	24.2	26.4	28.7	29.2	1.6	1.7
Tunisia	8.2	9.0	9.6	9.7	1.4	1.3
Jordan	3.5	4.3	5.0	5.2	3.0	3.2
Lebanon	2.6	3.2	3.5	3.6	1.7	2.0
Occ. Palest. Terr.	n.a.	n.a.	3.0	3.0	0.0	n.a.
Syria	12.1	14.2	16.6	17.1	3.1	3.2
Belarus	n.a.	10.3	10.0	10.0	0.0	-0.5
Moldova	n.a.	4.3	4.3	4.3	0.0	0.0
Russian Fed.	n.a.	148.3	145.4	144.8	-0.4	-0.4
Ukraine	n.a.	51.5	49.3	49.1	-0.4	-0.8

Source: IMF, EBRD, EIU, World Bank

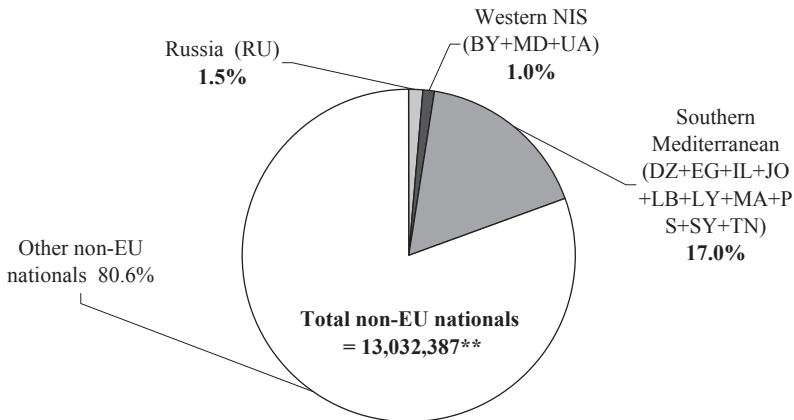
**Chart 9: Immigration of Southern Mediterranean, Western NIS, and Russian nationals to the Acceding countries as percentages of all non-national immigrants, 1999\***



\* Source: Eurostat. No data available for PL. 2001 data: SK

\*\* Includes non-national immigrants into MT but nationality-specific details for Eastern and Southern countries are not available

**Chart 10: Southern Mediterranean, Western NIS, and Russian nationals as percentages of all non-EU nationals in the EU-15, 2001\***



\* Source: Eurostat. 2000 data: B, I, A, P, S, UK. 1999 data: F. 1998 data: EL

\*\* Includes non-EU nationals in A and IRL but nationality-specific details for Eastern and Southern countries are not available



**Assistance**  
**Community assistance to Russia, Western NIS and Southern**  
**Mediterranean countries 1995-2002 (commitments, € millions)**

	<i>Bilateral Aid 95-02</i>	<i>Meda Regional &amp; Tacis cross-border programme</i>	<i>MFA/Food Security Programme</i>	<i>Fuel gap</i>
Algeria	304.2			
WB/Gaza	307.7 + 151.1 <sup>1</sup>		112 <sup>5</sup> +10	
Egypt	776.7			
Jordan	381		2	
Lebanon	194			
Morocco	1,038.6			
Syria	181			
Tunisia	685.9			
Russia	912.3			
Ukraine	498.1		453	(97-01)
Moldova	62.7		50/15.5	
Belarus	17		30	
Total S. Med	3869.1 <sup>2</sup> +151.1	974.5 <sup>3</sup>	124	
Total Russia/WNIS	1490.1	1052.2 <sup>4</sup> (CBC:228.9, 96-03)	558/15.5	115

<sup>1</sup> B7-420B for 2000-2002

<sup>5</sup> Amount allocated via UNRWA, WFP and ACAD

<sup>2</sup> Meda, part B of the budget (B7-410B)

<sup>3</sup> Meda, parts A and B of the budget (B7410A and B7-410B). This does not include monies committed to the United Nations Relief and Works Agency for Palestinian Refugees in the Near East (UNWRA) for Palestinian refugees in Jordan, Lebanon, Syria and West Bank/Gaza

<sup>4</sup> Estimates based on Russia and Ukraine receiving a proportionate (50% and 25% respectively) share of the overall budget for the Tacis Regional Programme



## **COMMISSION OF THE EUROPEAN COMMUNITIES**

Brussels, 1.7.2003  
COM (2003) 393 final

### **COMMUNICATION FROM THE COMMISSION**

#### **Paving the way for a New Neighbourhood Instrument**

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  - II. Objectives
  - III. State-of-play of current co-operation
  - IV. Towards a Neighbourhood Instrument: A two phase approach
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    - Second Phase Post-2006: A New Neighbourhood Instrument
  - VI. Next Steps
- ANNEX 1 Proposed List of Neighbourhood Programmes

## **I. Introduction**

1. In its Communication “Wider Europe – Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours”<sup>1</sup> (hereafter “the Wider Europe Communication”), the Commission proposed that “the European Union should aim to develop a zone of prosperity and a friendly neighbourhood ... with whom the European Union enjoys close, peaceful and co-operative relations.” “... Over the coming decade and beyond, the Union’s capacity to provide security, stability and sustainable development to its citizens will no longer be distinguishable from its interest in close co-operation with the neighbours.” “The development of such a policy is a logical consequence of enlargement, which, as stated in the Communication “gives new impetus to the effort of drawing closer to the 385 million inhabitants of the countries who will find themselves on the external land and sea border, namely Russia, the Western NIS, and the Southern Mediterranean.”
2. One of the elements of the Wider Europe Communication was the specific possibility of creating a new Neighbourhood Instrument, “which builds on the experience of promoting cross-border co-operation within the PHARE, Tacis and INTERREG programmes”, and which could focus “on ensuring the smooth functioning and secure management of the future Eastern and Mediterranean borders, promoting sustainable economic and social development of the border regions and pursuing regional and transnational co-operation”. The new Instrument could also “help to avoid drawing new dividing lines in Europe and to promote stability and prosperity within and beyond the new borders of the Union.” The Wider Europe Communication also emphasises that cross-border cultural links gain additional importance in the context of proximity.

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<sup>1</sup> COM(2003) 104, 11 March 2003

The General Affairs and External Relations Council in June 2003 welcomed the Wider Europe Communication and invited the Commission to present a Communication on the concept of a new Neighbourhood Instrument as well as examining measures to improve interoperability between the different instruments. The Thessaloniki European Council endorsed these conclusions.

3. The Commission has examined the possibility of creating such an Instrument, using as a starting point the co-ordination work that has been taken forward in recent years between INTERREG, PHARE and Tacis. In order to ensure a comprehensive approach, the Instrument should also cover those neighbouring countries which benefit from CARDS and Euro-Med partnership, even though the Western Balkans fall outside the political scope of the Wider Europe Communication. Following the accession of Bulgaria and Romania to the European Union, their borders with the Western NIS and the Western Balkans will be future external borders of the Union, and are therefore also considered. The Wider Europe Communication does not bring Turkey within the scope of this Instrument, since Turkey benefits from a close relationship with the EU which goes well beyond the relationship between the EU and non-candidate neighbours.
4. This Communication provides an assessment of the possibilities of creating a new Neighbourhood Instrument. Taking into account the short-term constraints in the co-ordination between existing financial instruments (INTERREG, PHARE Cross-border Co-operation Programme, Tacis Cross-border Co-operation Programme, CARDS and Meda), the Commission proposes that a two-step approach should be adopted. An initial phase from 2004-2006 will focus on significantly improving co-ordination between the various financing instruments concerned within the existing legislative and financial framework. In a second phase, for the period after 2006, the Commission intends to propose a new legal instrument addressing the common challenges identified in the Wider Europe Communication.
5. This Communication is divided into four sections. After this introduction, a second section identifies the key objectives, while

the third section describes the current situation in relation to the existing co-operation instruments. The fourth section firstly sets out the practical steps that the Commission intends to implement immediately for the period up to 2006, in order to strengthen co-operation activities along the external border within the current legal framework, and then provides an initial analysis of further options for the period post-2006 by identifying key issues to be examined in relation to the creation of a future new Neighbourhood Instrument. The final section describes the actions to be taken in order to implement the proposals set out in the Communication.

## **II. Objectives**

6. The positive impact of enlargement on current and future Member States and on neighbouring countries will be considerable. At the same time the new opportunities brought by enlargement will be accompanied by new challenges: existing differences in living standards across the Union's borders with its neighbours may be accentuated as a result of faster growth in the new Member States than in their external neighbours; common challenges in fields such as the environment, public health, and the prevention of and fight against organised crime will have to be addressed; efficient and secure border management will be essential both to protect our shared borders and to facilitate legitimate trade and passage. No less importantly, the long-standing cultural links across these borders should be enhanced rather than hindered.

### **The external borders of the enlarged European Union after 2006**

**In the East**, the future eastern border of the EU with the NIS will be between eight Member States and four neighbouring countries. This land border will run from the Barents Sea in the North to the Black Sea in the South, stretching over 5000 km and covering regions with very different geographic, economic and social characteristics. The poverty gap on this border is substantial. Cultural ties on these borders are particularly important as the communities have a long history of living together across borders which have moved back and forth many times.

**In the South-east**, the future borders will concern the five Western Balkan countries, surrounded by six Member States. These countries have had historical links for many centuries. The current economic exchanges and the experience of legal development and the public administration reform process in the accession countries constitute the major interests for this type of co-operation.

**In the South**, the border between the European Union and the Eastern and Southern Mediterranean countries is almost exclusively maritime in nature and will be between eight Member States and ten neighbouring countries. It covers the length of the Mediterranean Sea (c. 5500 km) with the various maritime crossings varying significantly in distance. It is characterised by a significant development gap between the North and South of the Mediterranean but has close historical, cultural and human links.

7. Although the political, economic and social context varies from border to border (see box below), the key co-operation objectives to be addressed are broadly valid for all. The approach to be followed under the future new Neighbourhood Instrument should thus be applied equally, *mutatis mutandis*, to the current and future EU/Western NIS borders, EU/Western Balkans borders and EU/Mediterranean borders.

8. Within the broader context of the Wider Europe Communication, the above considerations suggest the following issues as relevant objectives both for the future new Neighbourhood Instrument, as well as for a first transitional phase.

8.1. *Promoting sustainable economic and social development in the border areas*

Closer co-operation between the European Union and its neighbours should help to accelerate economic and social development and poverty reduction in the border areas by increasing trade and investment flows, enhancing cross-border co-operation on economic and social policy issues, promoting co-operation in the fields of transport and energy, and integrating the neighbouring countries more deeply into wider European co-operation.

As a rule, proximity to EU markets will increase the economic attractiveness of external neighbouring areas and create new opportunities for them. Currently, these regions often have natural economic advantages such as cheaper labour and lower transport costs.

8.2. *Working together to address common challenges, in fields such as environment, public health, and the prevention of and fight against organised crime*

As indicated in the Wider Europe Communication, “threats to mutual security, whether from the trans-border dimension of environmental and nuclear hazards, communicable diseases, illegal immigration, trafficking, organised crime or terrorist networks, will require joint approaches in order to be addressed comprehensively.” While broader international co-operation is required to address many of these issues, regional and cross-border co-operation have an important role, and this should be specifically taken up by the new Instrument.

8.3. *Ensuring efficient and secure borders*

Efficient border management is essential for joint prosperity and security. Facilitating trade and passage, while securing European



Union borders against smuggling, trafficking, organised crime (including terrorist threats) and illegal immigration (including transit migration), will be of crucial importance. Regional and cross-border co-operation can assist in facing these challenges, although action at national level will also be required.

#### 8.4. *Promoting local, “people-to-people” type actions*

Bearing in mind the long-standing social and cultural links across the external borders of the Union, it is important that the new external EU border is not seen as a barrier to existing contact and co-operation at the local level. This type of co-operation has a long-standing tradition in particular on the land borders of the enlarged Union. Therefore, cross-border contacts at regional and local level should be encouraged, enhancing exchanges and deepening economic, social, cultural and educational co-operation between local communities.

This Instrument should complement and be coherent with other relevant EU policies and instruments, including national financial assistance programmes, as well as specific sectoral policies and instruments (e.g. Schengen Facility, EQUAL, TEMPUS, etc.).

### **III. State-of-play of Current Co-operation**

9. At present, co-operation on the external and future external borders of the European Union is supported by a variety of instruments (see box below). These instruments are governed by different regulations, and thus operate with different project identification, selection and implementation procedures, making it difficult to implement genuine joint projects (i.e. those serving a joint objective and operating on both sides of the border at the same time). This diversity of instruments and procedures, and the consequent weaknesses in implementation have led to frequent criticism by the Court of Auditors, the European Parliament and the Council.

### **EU instruments promoting cross border and sub-regional/transnational co-operation**

- The **INTERREG Community Initiative**<sup>2</sup>, a financial instrument within the framework of the European Union's Structural Funds, supports cross-border and transnational co-operation among Member States and neighbouring countries. Although INTERREG programmes involve neighbouring countries directly, Structural Funds can only be used inside the Union. INTERREG programmes at the European Union's external border therefore require a source of finance for activities taking place within the neighbouring country.
- In the framework of the pre-accession driven PHARE instrument in the candidate countries, the **PHARE CBC programmes**<sup>3</sup> support cross-border co-operation with Member States and between the candidate countries. So far, cross-border co-operation on candidate countries' external borders has been financed through national PHARE programmes. For the period 2004-2006, the geographical scope of PHARE CBC will be extended to cover the external borders of Bulgaria and Romania.
- In the NIS countries the **Tacis CBC programme**<sup>4</sup> supports cross-border co-operation in the western border regions of Russia, Belarus, Ukraine and Moldova. Of particular relevance in the present context is the "Small Project Facility", which has provided increasing support for cross-border and other co-operation initiatives with INTERREG.

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<sup>2</sup> Council Regulation (EC) No 1260/1999 of 26 June 1999 and the INTERREG III Guidelines, OJ C143, 23 May 2000

<sup>3</sup> Commission Regulation (EC) No 2760/98 of 18 December 1998

<sup>4</sup> Council Regulation (EC, Euratom) No 99/200 of 29 December 1999

- In the Western Balkans, **CARDS**<sup>5</sup> is a key instrument of the Stabilisation and Association process and supports a range of activities in this regard. The CARDS regulation identifies the goal of fostering regional, transnational, cross-border and interregional co-operation among the recipient countries, between them and the European Union and between the recipient countries and other countries of the region. No cross-border co-operation programme yet exists in the CARDS framework.
- In the Mediterranean, the **Meda programme**<sup>6</sup> provides support for regional co-operation in the broader sense between countries on the southern and eastern shore of the Mediterranean but has not as yet funded direct co-operation activities with Member States.

10. The current legal frameworks and procedures for this co-operation have been effective in their own right, but have created a number of difficulties, which limit the impact of co-operation along the external borders. These difficulties arise from the fundamentally diverging systems applied to the financial management of Community funds, implying different roles and responsibilities for the Commission and the national, regional or local authorities. Differences arise, in particular, in the mismatched levels of funding, the programming process (separate programming exercises), project selection (separate assessment and selection processes and decision procedures), project implementation (different rules governing internal and external procurement processes), and project monitoring (different reporting, monitoring and evaluation procedures).

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<sup>5</sup> Council Regulation (EC) No 2666/2000 of 5 December 2000

<sup>6</sup> Council Regulation (EC) No 2698/2000 of 27 November 2000

#### **IV. Towards a Neighbourhood Instrument: A Two Phase Approach**

11. The Commission has made considerable progress in improving co-ordination between INTERREG and PHARE CBC, where joint co-ordination structures, joint programming and selection procedures have been in place for several years. Progress has also been made in co-ordinating INTERREG and Tacis CBC, notably on the Finnish/Russian border. The impact of such co-ordination measures will always be constrained by the existence of different legal and budgetary frameworks. The concept of a new Neighbourhood Instrument offers the opportunity to develop a single approach to co-operation across the external borders of the Union, which would resolve the problems faced at present.
12. However, a new Neighbourhood Instrument raises a number of significant legal and budgetary questions related in particular, to the present separation between external and internal funding sources. These cannot be resolved immediately. In addition, given that the current financial perspectives extend to the end of 2006, and taking account of the fact that financial commitments have already been made for some instruments up to that date, the Commission intends to proceed in two separate phases: the initial phase, up to 2006, should involve working within the existing legal framework and should seek in a pragmatic and dynamic way to improve current procedures and increase the effectiveness and visibility of co-operation. A more far-reaching solution, involving the creation of a new Neighbourhood Instrument should be sought for the period from 2007 onwards, following an assessment of the relevant legal and budgetary issues.

#### **First Phase 2004-2006: Introducing Neighbourhood Programmes**

13. For the 2004-2006 period the key objective should be to build on existing progress made in co-ordinating the various instruments, while fulfilling existing commitments and obligations regarding the current programming period up to the end of 2006. In this context, the particular pre-accession needs of Bulgaria and Romania should be fully taken into account.

14. As a first step, the Commission therefore proposes for this period the introduction of **Neighbourhood Programmes** covering the external borders of the enlarged Union. These programmes will be prepared jointly by relevant stakeholders on both sides of the border. The Neighbourhood Programmes will cover a broad range of actions flowing from the objectives in point 8 above and may include, for example, infrastructure in the sectors of transport, environment, energy, border crossings, electronic communications; investments in economic and social cohesion (productive investments, human resource development, business-related infrastructure, co-operation in the fields of research and technology and innovation); people-to-people actions (like cultural and educational exchanges and co-operation); promoting the management of the movement of people and support to institution building (including justice and home affairs, border and customs management and meeting other common challenges). It should be noted however that certain issues related to proximity policy may still need to be taken up within the national programmes. In preparing the Neighbourhood Programmes, co-ordination with other current and ongoing co-operation programmes, and full coherence with the relevant country and regional strategy papers, will be assured.
15. Such Neighbourhood Programmes would permit a single application process, including a single call for proposals covering both sides of the border, and would have a joint selection process for projects. The funding for these Neighbourhood Programmes would come from the allocations already earmarked for existing programmes, and the formal decision processes would remain as at present. A list of possible Neighbourhood Programmes is given in Annex 1.
16. **INTERREG** programmes are prepared in the border areas by partnerships involving the national, regional and local level of the countries concerned. As such, they are already decentralised and could therefore form a useful basis for the Neighbourhood Programmes. The current geographical distribution of these INTERREG programmes will be an appropriate basis for the geographical scope of the Neighbourhood Programmes. These

programmes include both bilateral cross-border co-operation programmes (INTERREG A) and wider sub-regional and transnational co-operation programmes (INTERREG B). The latter also allow for bilateral projects, if they are expected to have a wider transnational impact. Where programmes already exist (e.g. the Finland-Russia border), they may need to be modified in the sense of covering a broader range of objectives, and taking full account of issues and priorities on both sides of the border. In addition, the Commission will amend the INTERREG guidelines to allow the possibility of developing more direct co-operation between Member States and the Meda partners.

On the **Tacis** side, a new Strategy Paper and Indicative Programme for the Cross border co-operation Programme for 2004-2006 and the yearly action programmes thereunder will be drawn up incorporating the necessary changes required by the Neighbourhood Programmes, i.a. separate indicative budget allocations per each Neighbourhood Programme.

For **CARDS**, the considerations required by the Neighbourhood Programmes will be incorporated into the Multiannual Indicative Regional Programme and the yearly action programmes thereunder.

For **Meda**, the multiannual indicative programming exercise for 2004-2006 will incorporate the Neighbourhood approach with specific programmes for co-operation with the Member States.

For the Bulgarian and Romanian borders with the Western NIS and Western Balkans (future external borders), **PHARE CBC** programmes will be established to cover the 2004-2006 period and will provide a useful basis for the Neighbourhood Programmes.

17. The Neighbourhood Programme approach will result in single projects operating on both sides of the border. The internal and external components of each project will therefore be implemented concurrently, rather than consecutively or separately.

### **New Neighbourhood Programmes for the External Borders**

In order to create a Neighbourhood Programme including INTERREG, PHARE CBC, Tacis, CARDS and Meda, the main steps will include the following:

- A specific funding allocation, within the current financial perspectives, will be made within the relevant external instruments to the area covered by each Neighbourhood programme. The funding for the Member State(s) concerned would be fixed by the Commission decision adopting the Structural Fund element of the programme;
- The programme's priorities will take account of necessary objectives and activities on both sides of the border and the aims and objectives of the Wider Europe Communication;
- The rules governing the programme's committee structures will ensure a balanced membership from both sides of the border, and include the appropriate representation of the Commission;
- A single application process and a single selection process will operate for each programme covering both the internal and the external element of a single project;
- Procedures for a final decision on the external and internal components of the jointly selected projects, and for contracting and making payments, will remain those required by the relevant regulations;
- Procedures for monitoring, reporting and evaluation will be harmonised for both components. A system for a regular exchange of best practices and experiences on the basis of the results of the various projects should also be encouraged.

18. Such a process will not require new financial rules, as Structural Funds will still be used inside the Union, and external funds outside. It will allow the selection of the joint projects (each with an internal and external component) to be made by the Neighbourhood Programme's selection committee in which relevant local and national officials from both sides of the border will participate.
19. Legally, the components of these programmes relating to activity within the Member States will still be INTERREG programmes, and they will therefore remain in the Structural Funds framework. The external components of these programmes will remain within the framework of the respective Regulation, and will implement the respective Strategy and Indicative and Action programmes adopted by the Commission following consultation of the relevant management committee. From the perspective of the stakeholders, however, the two components will operate as one single Neighbourhood Programme.
20. Although the Neighbourhood Programmes will operate within the current financial perspectives and programming for the years 2004-06, it is important that a sufficient volume of funding is made available to permit the real impact and visibility of these programmes, and to encourage the active involvement of stakeholders on both sides of the border. Neighbourhood Programmes must also take account of practical questions of management and absorptive capacity. Without prejudging the normal budgetary and programming processes, the Commission foresees at this stage that it should be possible, within the existing instruments and financial programming, to propose a total volume of funding for these programmes over the period 2004-06 of the order of €955 million, representing €700m from INTERREG, €90m from PHARE, €75m from Tacis, €45m from CARDS and €45m from Meda. The Commission will present more detailed proposals on the external instrument funding per Neighbourhood Programme to the relevant Management Committees in the normal way, at a later stage.



## Second Phase Post-2006: A New Neighbourhood Instrument

21. The approach described in the previous section provides a positive solution to many of the barriers already identified concerning the co-ordination of the various instruments. It also paves the way to establish a new Neighbourhood Instrument post 2006.
22. Such an Instrument, capable of operating on an identical footing on both sides of the EU's external border, would provide a more complete approach, allowing for a mix of cross-border and regional co-operation activity to be developed around the external border. In addition, it would address the practical difficulties that are likely to remain even after the actions described above are implemented, including restrictions on where and how funding can be used.

### Different agendas for different regions

A Neighbourhood Instrument for the external borders of the enlarged European Union would logically be linked to, and coherent with, the various external policy agendas and processes and should take account of the different regional priorities already developed.

**In the East**, the cross border dimension would be of key importance given the length of the land border. However, the Communication on Wider Europe mentions that "*New initiatives to encourage regional co-operation between Russia and the countries of the Western NIS might also be considered. These could draw upon the Northern Dimension concept to take a broader and more inclusive approach to dealing with neighbourhood issues.*"

**In the Western Balkans**, CARDS provides a strategic approach to the provision of assistance to the countries of the region and aims to help the Balkan countries in the process towards future membership, and to establish a strategic framework for their relations with the EU. As defined in the CARDS regulation,

regional, cross-border, transnational and interregional co-operation must play a key role in this regard.

**In the Mediterranean**, land borders are of less significance, but short-sea crossings provide frequent and intensive connections between Member States and Southern and Eastern Mediterranean partners. Moreover, the Wider Europe Communication states that *“further regional and sub-regional co-operation and integration amongst the countries of the Southern Mediterranean will be strongly encouraged.”*

23. A Neighbourhood Instrument would combine both external policy objectives and economic and social cohesion. Such a combination of issues would offer continuity with the type of local and regional co-operation already developed successfully under INTERREG and PHARE CBC for example, while introducing into the scope of the co-operation additional, wider geopolitical objectives which will become increasingly important after enlargement, as outlined in the Wider Europe Communication.
24. Such an Instrument should draw on lessons learned from previous experience of implementing cross-border co-operation. In particular, it should be simple to operate and, in order to engender full ownership among all concerned stakeholders, it should involve all relevant partners at European, national, regional and local level.
25. Before developing such a concept further, the critical issue to be examined concerns the legal and budgetary constraints on the integration of internal and external European Union funding. At present, Community Structural Funds cannot be used outside the European Union, and external instruments cannot be used internally. As a response to this problem, the following alternatives may be considered:
  - expanding the content and geographical scope of an existing co-operation instrument to allow these funds to be used on both sides of the external border, thus creating a

Neighbourhood Instrument from an existing instrument (for example, permitting the use of INTERREG funds outside the Union);

- creating a single new Regulation to govern a Neighbourhood Instrument to fund activities both inside and outside the Union, and be based on a single budget line. Consideration should be also given to a single instrument operating on two separate budget lines. However, in this case questions relating to joint external and internal financing of projects would need to be resolved;
  - focusing further on co-ordination between already existing instruments on the basis of the Neighbourhood Programmes proposed for 2004-2006, learning from the experience subsequently acquired, and perhaps expanding on the objectives and financing of these programmes, while further improving procedures as appropriate.
26. These long-term options require further study, and the Commission is currently examining them to assess their feasibility and the impact that they would have on co-operation along the external borders.

## **VI. Next Steps**

27. The Commission intends to introduce Neighbourhood Programmes, as described in Section IV, immediately. This will involve:
- amending existing INTERREG programmes to take account of the Neighbourhood Programme concept;
  - ensuring that the Neighbourhood Programme concept is fully taken into account in the current preparations of INTERREG programmes in the acceding countries for their new external border programmes;
  - amending the INTERREG Guidelines to add the southern regions of Spain, France, Italy and Greece as eligible for co-

operation activities with the southern Mediterranean partners so as to allow bilateral cross-border co-operation;

- adopting the Indicative Programme for Tacis CBC 2004-2006 in autumn 2003 which incorporates the changes required;
  - allocating specific funds for Neighbourhood Programme co-operation under the Multiannual Indicative Regional Programme under CARDS for 2004-2006;
  - allocating specific funds for Neighbourhood Programme co-operation under the Meda multiannual programming exercise for 2004-2006;
  - integrating the Neighbourhood Programme concept in the preparation of 2004-2006 PHARE CBC programmes at the Bulgarian and Romanian borders with Western NIS and Western Balkans.
28. The legal and budgetary issues identified in part 2 of Section IV require further reflection within the Commission before a definitive position can be established. This reflection work is already underway and will continue in the second half of 2003.
29. The Commission intends to present orientations for the next Financial Perspectives by the end of 2003. In the light of these orientations and of the Third Cohesion Report The Commission will come forward with more detailed proposals for the New Neighbourhood Instrument post-2006.

**ANNEX 1**  
**Proposed initial list of Neighbourhood Programmes**

<i>Neighbourhood Programme</i>	<i>Countries involved</i>
Nord (Kolarctic)	Fin, S, N, Rus
Karelia	Fin, Rus
South-East Finland/Russia	Fin, Rus
Estonia/Latvia/Russia	EE, LV, Rus
Latvia/Lithuania/Belarus	LV, LT, Bel
Lithuania/Poland/Russia	LT, PL, Rus
Poland/Ukraine/Belarus	PL, UKR, Bel
Hungary/Slovakia/Ukraine	Hun, SLK, UKR
Slovenia/Hungary/Croatia	SLN, Hun, HR
Hungary/Romania/Serbia & Montenegro	HUN, Rom, SeM
Italy/Adriatic	I, HR, BiH, SM, ALB
Italy/Albania	I, ALB
Greece/Albania	GR, ALB
Greece/FYROM	GR, FYROM
Spain/Morocco	E, MAR
Gibraltar/Morocco	UK, MAR
Romania/Ukraine	Rom, UKR
Romania/Moldova	Rom, MOL
Bulgaria/Serbia & Montenegro	Bul, SeM
Bulgaria/FYROM	Bul, FYROM
Baltic Sea	D, DK, S, FIN, EE, LV, LT, PL, N, Rus, Bel
CADSES	D, A, I, GR, CZ, SLK, SLN, PL, HUN, ROM, BUL, HR, SeM, BiH, FYROM, ALB, UKR, MOL
Western Mediterranean	I, F, E, P, UK, Mal, (MAR, ALG, TUN)
Archimed	GR, I, Mal, Cyp, (TUR, EGY, ISR, LEB, SYR, Pal, Jor)

This list of programmes is only indicative and is based on INTERREG programmes for current and future Member States and on future PHARE CBC programmes on the external borders of the enlarged Union.

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