



**Center for Social and Economic Research**

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**Participation in the EU Internal  
Market: the experience of NMS  
and its relevance to the ENP**

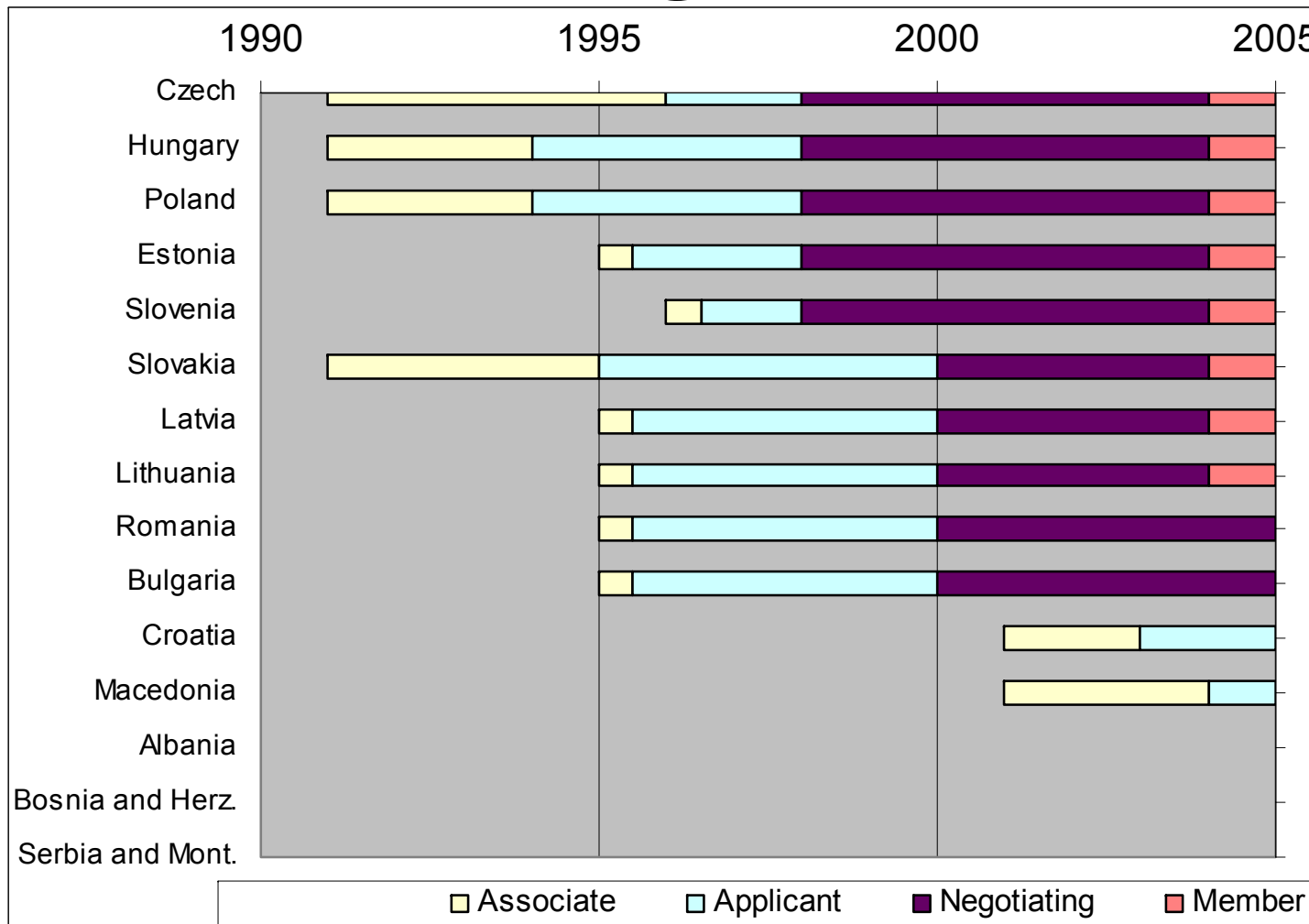
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## Merchandise Trade of Eastern Europe, by direction

|                                  | 1980  | 1990  | 2004  |
|----------------------------------|-------|-------|-------|
| World .....                      | 100.0 | 100.0 | 100.0 |
| Eastern Europe and the CIS ..... | 48.5  | 38.1  | 23.2  |
| CIS .....                        | 27.1  | 22.3  | 4.7   |
| Eastern Europe .....             | 21.4  | 15.8  | 18.5  |
| Developed market economies ..... | 35.7  | 49.5  | 71.0  |
| Developing economies .....       | 15.8  | 12.4  | 5.8   |

Source: UNECE *Economic Survey of Europe, 2005 No. 2, Appendix Table B14*

# EU integration process (embracing Balkans)



# **NMS – unfinished integration with the EU Internal Market**

- Transition arrangements related to free movement of labor
- Transition arrangements related to some services
- Transition arrangements related to land purchase
- Indirectly: EMU and Schengen

# Directions of Exports of Goods, 2004, World=100%

|                       | EU-25 | Acceding/<br>Candidate<br>Countries | CIS  | MENA |
|-----------------------|-------|-------------------------------------|------|------|
| <b>EU-25</b>          | 68.3  | 2.4                                 | 2.2  | 3.8  |
| <b>Belgium</b>        | 77.8  | 1.3                                 | 0.9  | 3.1  |
| <b>Czech Republic</b> | 83.8  | 3.0                                 | 2.4  | 1.6  |
| <b>Denmark</b>        | 68.5  | 1.0                                 | 1.8  | 2.5  |
| <b>Germany</b>        | 64.6  | 2.7                                 | 2.8  | 3.0  |
| <b>Estonia</b>        | 74.6  | 0.6                                 | 11.5 | 0.5  |
| <b>Greece</b>         | 60.1  | 15.6                                | 3.3  | 7.0  |
| <b>Spain</b>          | 75.2  | 2.5                                 | 0.9  | 5.2  |
| <b>France</b>         | 67.1  | 2.0                                 | 1.4  | 6.8  |
| <b>Ireland</b>        | 63.2  | 0.5                                 | 0.3  | 1.3  |
| <b>Italy</b>          | 60.4  | 4.8                                 | 2.6  | 6.3  |
| <b>Cyprus</b>         | 64.9  | 2.8                                 | 2.8  | 17.6 |
| <b>Latvia</b>         | 75.9  | 0.1                                 | 7.8  | 1.0  |
| <b>Lithuania</b>      | 61.3  | 2.1                                 | 15.2 | 0.1  |
| <b>Luxembourg</b>     | 90.4  | 0.7                                 | 0.8  | 1.0  |
| <b>Hungary</b>        | 80.7  | 6.0                                 | 3.2  | 2.2  |
| <b>Malta</b>          | 44.5  | 2.4                                 | 0.1  | 5.2  |
| <b>Netherlands</b>    | 81.0  | 1.4                                 | 1.6  | 2.3  |
| <b>Austria</b>        | 72.4  | 4.2                                 | 2.4  | 1.8  |
| <b>Poland</b>         | 79.1  | 3.1                                 | 7.9  | 1.2  |
| <b>Portugal</b>       | 80.8  | 0.9                                 | 0.3  | 1.8  |
| <b>Slovenia</b>       | 73.3  | 11.1                                | 5.1  | 2.1  |
| <b>Slovakia</b>       | 85.7  | 2.9                                 | 2.8  | 0.5  |
| <b>Finland</b>        | 58.3  | 1.1                                 | 9.9  | 4.7  |
| <b>Sweden</b>         | 59.1  | 1.3                                 | 2.1  | 3.2  |
| <b>United Kingdom</b> | 57.0  | 1.6                                 | 1.3  | 5.0  |

Source: European Economy 2005, No. 5, Table 57

# Sources of integration success of NMS

- Clear perspective of EU membership
  - Strong incentives to conduct reforms and open the economy
  - Guidelines how to reform (*acquis*)  $\Rightarrow$  mass-scale institutional import
  - Package solutions (loses in one area could be compensated in another area)
- Generous EU offer at the association stage
  - Asymmetric trade liberalization
  - TAA before or parallelly to WTO accession
  - Early abolishing of visa regime
  - Substantial aid package

# The magnetism of EU membership

- Political ('club') membership
- Historical links and cultural proximity
- Geopolitics and security
- Four basic freedoms (goods, services, capital, labor)
- Prospects of prosperity
- Structural funds

$\Sigma$  = the magnetism of a Western European prosperity, freedom and lifestyle

# Limited relevance of NMS experience

- The ENP offer does not include the EU membership perspective
- The ENP is unlikely to provide a fast-track full participation of neighbors in the EU internal market (particularly for CIS); more realistic option: selective participation in some segments of EU internal market ⇒ selective institutional harmonization with *acquis*
- Integration “fatigue” in Western Europe
- Institutional problems in neighborhood countries are different comparing to those of NMS in 1990s and early 2000s (particularly in the case of Southern neighbors)

**Possibly more similarities  
to the current and future  
EU accession process of  
Turkey and Western  
Balkans**

# Consequences of differences

- Weaker incentives to domestic reforms and integration
- Lack of package effect  $\Rightarrow$  sectoral negotiations driven by narrow sectoral interests on both sides
- Weaker reinforcement effect (integration progress helps to build a pro-integration constituency)

# Limited market integration with neighbors

- Southern neighbors: association agreements with long implementation period (up to 12 years); asymmetric liberalization for manufactured goods; important sectors (like agriculture or services) only partly covered or excluded
- CIS: only PCAs so far; postponing start of trade liberalization negotiations after WTO accession process will be completed (difference with NMS and Balkans)
- Restriction on movement of people (visa regimes)
- Various degree of liberalization of capital movement in neighboring countries but limited real flows due to poor investment climate

# Integration obstacles (neighbors side)

- Failure to meet Copenhagen criteria
  - Deficit of democracy, human rights and rule of law
  - Poor business climate, excessive protectionism, government interventionism and etatism
  - Weak institutions
- Limited interest in advanced forms of European integration (due to historical and cultural differences) with some exceptions like Moldova and Ukraine

# Integration obstacles (EU side)

- Integration ‘fatigue’
- Cultural differences/ prejudices
- Income differences
- Migration/ security fears
- Unreformed CAP, welfare state and other structural rigidities
- Limited economic potential of neighbors

# Arguments in favor of closer integration of neighbors with the EU

- Geopolitics and regional security
- Window of opportunity for economic, social and political modernization of ‘neighbors’
- Energy supply and transit
- Transport routes
- Controlling migration flows
- Economic, cultural and ‘historical’ interests of ‘frontier’ EU member states

## **Conditions of successful integration:**

1. Trade expansion will depend not only on trade liberalization *per se* but also on neighbors' investment climate, speed of institutional harmonization and, to some extent, on liberalization of movement of people.
2. Intensification of foreign investment inflow to neighbors will depend not only on improvement of domestic investment climates (determined by a speed of institutional harmonization) but also on trade liberalization (market access).

# Conditions of successful integration (cont.):

3. Intensification of trade and FDI and the resulting diminishing of the income gap can weaken the income motive of labor migration and make freer movement of people less politically controversial in the EU. To some extent, free movement of goods and capital may serve as a substitute to the free movement of labor.
4. Free movement of people is important for balancing national labor markets, current accounts, development of the domestic SME sector and learning experience of more mature market economies and democratic societies, therefore strengthening pro-reform constituencies in 'origin' countries.

## Conditions of successful integration (cont.):

5. Institutional harmonization involves substantial costs. The traditional pay-off offered by the EU (modest improvement of trade access and technical assistance) is insufficient. A stronger set of incentives should include a faster pace of trade liberalization and liberalization of movement of people. For countries, which are interested in EU membership, such a perspective should not be ruled out *a priori*.