

Discours de M. Jacques de Larosière en date du 15 octobre 2002

## **Central and Eastern European Countries : their progress toward accession to the European Union**

Since our last meeting in February of this year, the process of accession of Central and Eastern European countries to the European Union has made significant advances. But more work is still needed.

I shall organize my presentation around two topics :

- the legal and regulatory work on accession as well as the political consensus on enlargement had made considerable progress, although many conditions are still to be met ;
- the macroeconomic developments in the candidate countries are encouraging but need further improvement.

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### **I. The legal and regulatory progress on accession and the political consensus on enlargement have made considerable progress, but many conditions remain to be met :**

#### **1. The progress made :**

The European Union members have decided, at the Göteborg Summit, last year, that a first wave of accession should in principle be possible by 2004.

This has been confirmed by the results of the negotiations which took place in 2002 between the European Union and the candidate countries.

Indeed, the Commission has just issued a strategy and progress report on October 9<sup>th</sup>, 2002, of which I will give you the essential elements.

After a thorough and comprehensive analysis, the Commission is now proposing that the accession negotiations with Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia be concluded by the end of 2002. As Commissioner Verheugen stated : "The reason behind this recommendation is very simple : the countries have earned it. Through their own efforts they have fulfilled accession criteria".

The Union's pre-accession strategy has thus proved a success. Bilateral negotiations between the Union and each candidate country which have been conducted since 1997, have covered most of the subjects (called "chapters") of the "acquis communautaire" which is the body of laws and rules that govern most economic, social and structural issues in the Union.

As you will see, from Annex I, out of thirty chapters, 28 on average have been covered and closed. In the following months work has to be pursued on the remaining two to three chapters that still have to be dealt with in several candidate countries (notably on agriculture and financial policies).

The Commission is nonetheless confident that the negotiations can be concluded by the end of 2002. This would allow the candidates, after the ratification process of the Accession Treaty, to become members at the earliest in 2004. They could, then, participate, if all goes well, in the European Parliamentary elections of 2004. The Summit that will convene in Copenhagen in December 2002 will probably confirm this orientation.

As far as Bulgaria and Romania are concerned, given the slower progress made by those two countries, accession date has been set, in principle, at 2007.

## 2. But many conditions remain to be met before accession becomes a reality:

### a) On the side of the present European Union members :

- First, the Treaty of Nice must be ratified. You know that the Treaty has laid out the legal framework for accession and, in particular, has determined the voting rights of the new members in the Council of Ministers. The recent vote in Ireland is important in this respect ;
- Second, the Union has to settle the institutional issues which are still unresolved and which are a prerequisite for a well functioning and workable Union of 25 members (this covers, in particular, the issues of majority votes and the number of Commissioners). ;
- Third, the "financial package", i.e. the budgetary impact of the accession has to be solved. Presently, the agreement is that, until 2006, accession should not increase the maximum percentage of resources allocated to the Union (1,27 % of total EU GDP). This principle would, if strictly applied after 2006, raise difficult problems regarding common agricultural policy<sup>1</sup>, regional and structural aids. It is clear that these major problems will have to be tackled in the coming months.

### b) On the side of the candidate countries :

They must carry on preparing for membership even after the negotiations have closed, until they actually join the EU. In particular, they must honor the commitments they have made during the negotiations.

Although a large portion of the "acquis communautaire" has been adopted by candidate countries, further improvements must be made to their administrative and institutional capacity to implement the new rules.

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<sup>1</sup> The Commission has proposed, for example, that farmers in the new member countries would have to wait ten years before receiving full direct aid. Poland -whose rural parties constitute a strong political force- considers such a transition period as too long.

The Commission will continue with its regular monitoring to follow developments in these areas over the coming months. A final comprehensive report will be produced six months before accession.

## **II. The macroeconomic developments in candidate countries are encouraging but need further improvements :**

### **1. Economic convergence :**

If the adoption of the "acquis communautaire" is well advanced, what about real economic convergence ?

Let me address the issue under three headings.

#### **a) Trade integration is now almost completed :**

The degree of openness of the group has significantly increased. Related to GDP exports and imports in the Czech Republic amount to 93 % (compared to 66 % in Germany). In Hungary, the figure is 66, 7 %, for example.

But, even more striking, is the redirection of trade. Whilst the bulk of these countries exports were destined to the Comecon before 1990, the share of the European Union in their exports has dramatically increased (from 42 % in 1991 to 75 % in 2001 in Hungary ; respectively 38 % and 69 % in Czech republic, 52 % to 70 % in Poland and Estonia, for example).

One should also note the significant change that took place in the composition of those exports. The share of products incorporating high technology has gone up from 21 % in 1995 to 45 % in 2000 for Hungary, from 11 % to 24 % in Czech Republic, from 10 to 20 % in Poland.

#### **b) Structural reforms are changing the economic fundamentals of those economies :**

The sectoral break up of the economy has dramatically changed.

For example, the agricultural sector has decreased its weight in GDP. It has declined on average since 1992 from 7 % to 3,5 % of GDP (against 2,3 % for the European Union at large).

Conversely, the share of services has significantly increased from about 50 % to 60 %, while industry has slightly reduced around 35-40 %.

Foreign direct investment -stimulated after 1995 by the acceleration of privatization- has powerfully contributed to the modernization and transition of the productive base of these countries, especially in the banking and telecommunications sectors.

### c) The catching up process is moving forward :

Countries like Slovenia (69 %, of EU average in terms of GDP per capita), Czech Republic (57 %), Hungary (52 %), Estonia (42 %), Poland (48 %), are the most advanced. At the other side of the spectrum, Romania represents 25 %, Bulgaria 28 % , and Turkey 22 %.

An example can be given in terms of use of communication technology. If you look at fixed lines & mobile phones per 1000 habitants, you observe that vs the European Union average (1.145) countries like the Czech Republic (802), Hungary (674), Poland (456) are catching up fast.

In terms of productivity growth, the catching up is under way. Labor productivity growth in the private sector in the Czech Republic and in Hungary in 2000 is similar to the one of Spain and of Portugal one year before they accessed the EU (i.e. 4 %). On the whole, one can assume that productivity growth in the candidate countries will outperform that of the EU by some 2 percentage points. But, the increases in local wages will reduce the net competitive advantage stemming from higher productivity.

### 2. But, in spite of the structural progress, more adjustment is needed to achieve nominal convergence :

Several problems must be addressed :

#### a) the fiscal deficits :

Fiscal deterioration is a problem in almost all applicant countries. The causes are well known : heavy administration, cost of infrastructure investments (environment, transport, housing), recent slowdown in EU economies which affects the exports of this group of countries.

In 2001, deficits related to GDP have generally increased (for example : 5,5 % in the Czech Republic, 4 % in Hungary and in Poland) while discipline remains the name of the game in Estonia (- 0,4 %).

#### b) the current account deficits :

In a number of candidate countries, current account deficits are on the high side (ex. 4,1 % of DGP in Poland, 4,7 % in Czech Republic).

These figures are high and can only be durably financed by foreign direct investment which does not seem to be increasing recently.

#### b) Inflation is to be watched :

Inflation has been considerably reduced after the first years of the post transition phase -and is still under control. The objectives set for the end of 2002 will probably be met in most of those countries (in spite of some slippage like in Hungary).

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All this means that the Maastricht criteria (which have to be fulfilled for the integration in the Euro system) are not impossible to meet in, let us say, a time horizon of 4 to 5 years.

But we have to remember that the present nominal convergence figures are, to some extent, propped up by relatively strong exchange rates. Let us not forget that the so called Balassa-Samuelson effect may be deteriorating competitiveness in the non exchangeable sector of goods and services. If this were true, there would be a case for a continuing flexibility in the management of the exchange rate.

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### Conclusion :

In conclusion, I should like to stress that the magnitude of the challenge for EU should be neither over nor underestimated.

“The accession of the ten applicants of the region would increase the population of the EU by more than one quarter and its surface area by around one third. But the “economic” size of the EU would increase by much less reflecting the much lower level of income and wealth in the accession countries : GDP on a purchasing-power-parity would increase by 11 %, while average GDP per capita would decline by 13 %.” (IMF World Economic Outlook 2000).

All of the Central and Eastern European countries have made progress but there still remain considerable differences between countries within the region. The “most advanced” of these countries (Czech Republic, Hungary, Poland, Slovenia and the Baltic States) began accession negotiations in 1998 and are now getting closer to EU countries on a number of indicators. On a PPP basis, the average per capita income of this first group (around 10 200 dollars) remains less than half of that of the EU (22 300 dollars). But things are changing. Slovenia, for example, has already a per capita income higher than the one of Greece, the poorest existing EU member.

With GDP rates of growth of 4 to 5 %, as we have seen earlier and with rising increases in productivity (especially in Poland and Hungary), the catching up process is moving ahead.

One should not forget that previous EU enlargements posed similar -albeit lesser- problems to the existing EU. At least for the “most advanced” candidates, significant progress is being made in terms of GDP per capita, reduction of inflation, fiscal discipline and trade openness compared to previous enlargement experiences.

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