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Check against delivery !

Regional Integration: Is the Acquis a Magic Bullet?

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Ladies and Gentlemen,

It is a great honor and pleasure for me to address this esteemed audience at the Brussels Economic Forum. I also would like to thank the organizers, especially Commissioner Joaquin Almunia, for inviting me.

The title of my speech is: “Regional Integration: Is the Acquis a Magic Bullet?” Well, the “acquis communautaire,” which represents the content, principles and political objectives of the treaties on which the EU is founded and the body of EU legislation, certainly is one of, if not *the* most important instrument in the process of European integration.

The first question which arises is - what are the major challenges in the integration process in Southeastern Europe and what can the acquis contribute to meeting these challenges?

During the accession negotiations, candidate countries face the enormous task of creating the conditions for accession by transposing Community legislation into national legislation. Furthermore, and equally importantly, they have to ensure that this legislation is effectively implemented and enforced. Establishing the appropriate administrative and judicial structures to this end has proved to be particularly challenging.

The accession talks with the ten new EU Member States and with Bulgaria and Romania have shown us that the adoption and implementation of the acquis is much more than a purely formal requirement. To underline this point, let me quote the Kok Report on the 2004 enlargement: "In the future member states of Central and Eastern Europe, stable democracies have emerged with democratic institutions and increased respect for minorities. Their economic reforms are yielding high rates of economic growth and better employment prospects.

This process has been encouraged by the prospects of EU membership, and by financial assistance from the EU, as well as from other international institutions. The conditionality of the criteria for EU membership has had a strong impact on the pace of reforms, and made them irreversible."

I would like to point out that this statement fits very well with the results and messages of recent economic research on the relation between institutions and growth.

For instance, a study of the EU-15 conducted at the Oesterreichische Nationalbank[i] not only identified a growth-enhancing effect of EU membership on economic growth, but also found that this effect increases with the duration of membership. What is even more important for Central and Eastern European countries, the findings of this study show that this growth bonus has been larger for countries with a lower initial income level. According to the authors, this phenomenon is largely attributable to improvements in the institutional framework as a result of EU membership, which includes changes in the legal and institutional framework of the financial sector.

Obviously, given that the acquis represents the common rules, standards and policies that make up the body of EU law, it significantly shapes the quality of institutions in the Union. Consequently, the adoption and implementation of the acquis means that the candidate countries' institutional frameworks have to undergo significant transformation during the accession process and even after accession. Moreover, in the past, intense scrutiny of the implementation of the acquis has proved helpful in ensuring continuous progress in the preparation for EU membership. The role the European Commission has played in this complex monitoring process cannot be overstated.

What did the link between the adoption and the implementation of the acquis on the one hand, and institutional and economic reform on the other hand, imply for the ten new Member States and the two acceding countries, Bulgaria and Romania?

The evolution of the EBRD's overall transition indicators since 1989 gives evidence that the eight New EU Member States from Central and Eastern Europe and the two acceding countries have succeeded in transforming their economies from centrally planned to market economies. In both country groups, the largest progress has been achieved in the areas of privatization, price-, foreign exchange- and trade-liberalization, and in banking, where the indicator reached or came very close to its maximum value by 2005. In addition, differences between individual countries have narrowed, suggesting that "transition laggards" have managed to catch up with their peers. Moreover, a comparison of this reform progress with developments in other transition economies in the region clearly suggests that the prospect of EU accession has played an important role in fostering reforms.

The World Bank indicators, in turn, measure the quality of governance in six dimensions: voice and accountability; political instability and violence; government effectiveness; regulatory quality; rule of law, and control of corruption.

Broadly similar to the EBRD's reform indicators, these governance indicators also show that the new Member States and the two acceding countries have achieved measurable improvement since 1996 and that the gap to the EU-15 has narrowed.

Institutional reforms during the accession process have translated into economic benefits in these countries. As they anchored their institutional structures to the EU, these countries have been viewed as more secure places for investing and doing business in general.

Improved property rights, more effective bankruptcy regulation, safeguards for competition, social reforms in accordance with the European Social Charter, the removal of trade barriers, easier access to finance both domestically and abroad – all these factors supported the achievement of sustainable growth.

Reflecting improved business conditions, privatization and better business perceptions on the side of foreign investors, direct investment inflows increased in the run-up to EU accession. Capital inflows, along with the development of the domestic financial system, have underpinned economic growth and a narrowing of the gap in GDP per capita compared with the EU-15. Catching-up has even accelerated since 2000,[ii] coinciding with the stepping-up of the EU enlargement dynamics. However, among the Southeastern

European countries, only Croatia managed to record a similar catching-up progress. These facts suggest that EU negotiations and the establishment and implementation of EU-compatible institutions and procedures have played a beneficial role.

In addition, the new Member States as well as Bulgaria and Romania have achieved a high degree of integration with the EU-15 over the past decade. Trade links deepened in both directions following the start of the transition process, owing – among other things – to the gradual dismantling of trade barriers in the framework of Association Agreements. The EU-15 is today not only the most important trading partner in the region, but also its biggest foreign investor. As a result, the EU-15 countries account for approximately three quarters of the total FDI stock in the region. This is particularly true for the banking sector, where foreign-owned banks have gained an average market share of around 70%.

Empirical work at the Oesterreichische Nationalbank[iii] emphasizes that privatization and restructuring of the banking sector in the new EU Member States as well as regulatory reforms of the financial markets have improved confidence and promoted domestic private sector savings, which is a particularly important source of banks' financing of the credit expansion in many countries.

Notwithstanding the impressive reform advances made over the past few years, efforts will have to continue in several areas, e.g. on promoting competition, on the modernization of the infrastructure, and on the development of non-bank financial institutions and capital markets.

The areas of necessary action in Bulgaria and Romania greatly overlap with those in the new Member States. However, in some specific policy fields such as enterprise restructuring, the development of non-bank financial institutions and capital markets, the need for reforms still seems to be more pronounced. With respect to governance, the largest deficits in the new Member States and the acceding countries compared with the EU-15 were recorded in the field of control of corruption, the rule of law and government effectiveness.

Generally speaking, the overview of economic and institutional reforms and of economic developments suggests that the new Member States have already reached a stage where they clearly benefit from the adoption and implementation of the acquis.

Bulgaria and Romania have also started to benefit from this process, but will have to proceed consequently on this road to make institutional and economic catching up an evolving and lasting success. The monitoring reports on Bulgaria and Romania, published earlier this week by the European Commission, pinpoint the remaining shortcomings which have to be addressed urgently.

Let me note, at this point, that the incentive structure for reforms following accession to the EU differs from that in the pre-accession period. During the accession negotiations, the conditionality of negotiations and the possibility of accession being delayed or in the worst case even denied, proved to be an effective instrument to promote transition. This very strong sanctioning mechanism weakens significantly once a country has joined the EU.

Hence, the <u>role of self-discipline</u> becomes more important. For that reason, this self-restraint is reinforced in the EU by the consistent implementation of existing rules and multilateral surveillance mechanisms. In this respect, the Broad Economic Policy Guidelines, the Employment Guidelines, the Lisbon National Reform Programs, the Stability and Growth Pact and the annual stability and convergence programs are essential instruments. Last but not least, EU Member States are expected to join the euro area at one point of time, and thus have to aim at fulfilling the Maastricht convergence criteria in a sustainable way.

Let me now turn to the candidate[iv] and potential candidate countries[v] of Southeastern Europe.

Since the Thessaloniki summit in June 2003, these countries have achieved considerable progress in stabilization and reconciliation, internal reform and regional cooperation. Political cooperation among the countries of the region and with the EU has intensified.

As for economic developments, these countries have made progress towards achieving macroeconomic stability and increasing competitiveness. Cooperation has intensified as well, with regular economic dialogues having been established between relevant institutions of the EU and the candidate and potential candidate countries. Progress has also been achieved in trade-related areas. With regard to the quality of institutions, progress in the area of justice, freedom and security has been significant.

This progress is also reflected in a gradual and continuous improvement in the EBRD's transition indicators and the World Bank's indicator for governance. These indicators confirm that these countries have achieved considerable progress over the past decade in coming closer to the standards of an industrialized market economy and in improving their institutional frameworks. In this respect, I would like to mention Croatia as an outstanding positive example in terms of both the transition and the governance indicators.

Nevertheless, comparing the level of transition and governance indicators for the candidate and potential candidate countries with the current level in the new Member States and in the acceding countries, the need for further reform efforts in the candidate and potential candidate countries becomes very evident.

With regard to the EBRD's transition indicators, reforms are most advanced in the areas of privatization, price-, foreign exchange- and trade-liberalization as well as banking, while they are lagging behind in the restructuring of enterprises, safeguarding of competition and in infrastructure.

Regarding the quality of institutions and governance, the largest deficits exist in fighting corruption, the rule of law, the effectiveness of government and political stability. In general terms, the level of the indicators is better for the candidate countries than for the potential candidate countries.

As for the economic performance in recent years, particularly in terms of inflation and fiscal developments, no clear distinction can be made between the new Member States and the acceding countries on the one hand, and the candidate and potential candidate countries on the other hand. However, GDP per capita levels are generally higher in the new Central and Eastern European Member States and in the acceding countries, and these ten countries have also experienced more rapid catching-up with the EU-15 over the past few years.

With regard to the level of integration, the enlarged EU is by far the most important export market for the candidate and potential candidate countries, and trade links have intensified recently.

FDI inflows accelerated over the past few years, and by 2004 the stock of FDI in most countries of the region had approached levels seen in Bulgaria and Romania. However, financial integration is less advanced. Nevertheless, foreign ownership in the banking sector has risen significantly over the past few years, and the dynamics strongly resemble those observed in the more advanced transition economies in the years prior to 2000 and 2001.

The example of the new Member States and the acceding countries makes me confident about the further progress in the reform of institutional structures, governance and economic sustainability in the Southeastern European candidate and potential candidate countries.

Naturally, this will require the continuation of substantial efforts on the side of the candidate and potential candidate countries.

However, if these efforts are forthcoming and prove to be genuine, I am convinced that the EU will also continue to grant assistance in this process to support institutional and economic reform.

The remarkable success of the acquis has given the impression that the acquis works like a magic bullet. Yet, the acquis can provide no quick fixes. Much rather, it can be likened to a strenuous training program that requires a lot of discipline.

As a consequence, the countries which have gone through this process will be in better shape and in a stronger position than before. But not only these countries, but all of us are going to gain as European integration is advancing, and thus stability and prosperity are progressing in Europe!

Thank you very much for your attention!

[i] Jesus Crespo Cuaresma et al.: "Growth Effects of European Integration: Implications for EU Enlargement", Focus on Transition, 1/2002 (OeNB).

[ii] These dynamics of the catching up process can be measured, for instance, by GDP per capita.

[iii] Peter Backé and Tina Zumer. 2005. Developments in Credit to the Private Sector in Central and Eastern European EU Member States: Emerging from Financial Repression – A Comparative Overview. In: Focus on European Economic Integration 2/2005. OeNB.

[iv] Croatia, the former Yugoslav Republic of Macedonia and Turkey are candidate countries.

[v] Albania, Bosnia and Herzegovina as well as Serbia and Montenegro including Kosovo under United Nations Security Council Resolution 1244 of June 10,1999, are potential candidate countries.