CHAPTER V

INTEGRATION WITH THE EUROPEAN UNION AND INTERNATIONAL ECONOMIC COOPERATION OF CENTRAL AND EASTERN EUROPEAN COUNTRIES AND THE COMMUNITY OF INDEPENDENT STATES

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5.1. THE PROGRESS OF INTEGRATION OF THE COUNTRIES OF CENTRAL AND EASTERN EUROPE WITH THE EUROPEAN UNION

The enlargement of the EU, which took place on May 1st, 2004, with ten new countries acceding, has changed the political map of Europe. The prevailing majority of our continent, in both the geographical and the economic sense, now consists of European Union member countries. Another few countries, from the Balkan region, are cooperating with the EU very closely. Romania and Bulgaria, who have agreed an accession treaty and signed it together with representatives of the 25 EU Member states on April 25th, 2004 in Luxembourg, are currently (end of June 2005) awaiting the completion of the process of its ratification. It is assumed that both these countries will be able to complete the necessary formalities in time to join the EU at the beginning of 2007.[1] Other Balkan countries – most notably Croatia and Macedonia – are at various stages of obtaining the status of European Union candidate country.

5.1.1. First assessments of the effects of EU enlargement

The single year that has passed since the EU enlargement date of May 1st, 2004, is too short a period to conduct a full analysis of the impact of enlargement on the overall economies or selected sectors. One can only speak of initial effects, some of which may be of a transitory nature. For example, the very good foreign trade performance of the new EU member countries in 2004 (in trade with both other EU countries and most other partners) probably cannot be fully sustained in future years.

In most of the new member states, the first year of accession has proved to be much more favourable than the Euro-sceptics were predicting.[2] In the final months of the run-up to accession, they were painting a gloomy picture of these countries having to pay extra for their EU membership and their markets being flooded by goods from the EU. After one year of European Union membership, one can conclude that these fears were unsubstantiated or grossly exaggerated.

In the economic dimension, the positive assessment of EU membership for the new member states is based above all on the following; the positive balance of transfers from the

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1 The Treaty on Bulgaria's and Romania's EU accession was signed by all parties on April 25th, 2005. It now needs to be ratified by all 27 countries. Until recently, it was assumed that this process would be completed in 2006, so as to allow the two new countries to join the Union at the beginning of 2007. In view of the EU political crisis associated with the rejection of the Constitution Treaty in France and Netherlands, some EU politicians are indicating that there is a need to slow down the pace of future EU enlargement (this mainly applies to future candidates, such as for example Croatia and Turkey), but one cannot exclude the possibility of a delay in the process of ratification of the treaty of accession of Bulgaria and Romania and, consequently, in the actual EU entry date of these countries.

2 For an assessment of the situation in Poland, see: E. Kawecka-Wyrzykowska, Pierwszy rok członkostwa Polski w Unii Europejskiej – obawy i rzeczywistość, [*The first year of Poland's membership of the European Union – the fears and the reality*] „Wspólnoty Europejskie" nr 4(161), April 2005 and Polska w Unii Europejskiej. Doświadczenia pierwszego roku członkostwa, [*Poland in the European Union. The experience of the first year of membership*] UKIE Warsaw 2005.

EU budget[3] and their very good foreign trade performance. In the political dimension, EU accession has given the new member states a far bigger say in the European Union's internal and foreign policies, and strengthened their international position, especially vis-à-vis third countries (e.g. Russia and other CIS countries).

Nearly all the new member states recorded a clear acceleration of their imports in 2004, compared to the previous years (Table 5.1.). Exports were rising particularly quickly within the group of new member states (EU-10); all the new member countries (with the exception of Slovenia) recorded annual export growth rates of 10%-25% in euro terms, with particularly high growth rates observed in the first months after accession.

Table 5.1. **Changes in the level of exports of the new EU member states (annually, as % of change of volume in euro terms)**

	Outside EU-15	Outside EU-25	to EU-15	to EU-25	to EU-10
Czech Republic					
2003/2002	0.9	-4.9	8.0	7.8	6.9
2004/2003	33.8	30.7	25.8	27.8	36.6
Jan. – Apr./ 2004/ Jan. – Apr. 2003	15.5	10.8	18.4	18.7	19.9
May – Dec. 2004/ May – Dec. 2003	42.3	40.4	29.5	32.3	44.0
Estonia					
2003/2002	8.6	5.3	10.4	10.9	13.0
2004/2003	42.8	35.0	9.4	16.8	52.5
Jan. – Apr. 2004/Jan. – Apr. 2003	27.7	15.4	11.7	16.6	42.8
May – Dec. 2004/ May – Dec. 2003	48.9	42.9	8.3	16.8	56.5
Hungary					
2003/2002	10.5	7.4	2.3	3.6	20.6
2004/2003	29.2	28.7	11.0	12.6	30.8
Jan. – Apr. 2004/ May – Dec. 2003	17.8	17.4	11.5	12.1	18.9
May – Dec. 2004/ May – Dec. 2003	34.0	33.2	10.7	12.8	36.2
Lithuania					
2003/2002	25.6	35.4	-3.4	0.5	10.2
2004/2003	16.4	8.3	27.1	28.6	31.9
Jan. – Apr. 2004/ Jan. – Apr. 2003	14.1	17.2	16.3	13.7	8.0
May – Dec. 2004/ May – Dec. 2003	17.4	4.2	31.7	35.0	42.2

[3] All new member countries reached an agreement with the EU-15, under which they would be net beneficiaries of funds from the EU budget from the beginning of their membership. There are no figures available on their actual net position in the first year of membership. Poland recorded a net inflow of 1.6 billion EUR in the first year of its EU membership. This is the difference between transfers received during the whole course of 2004, i.e. including pre-accession funds, and the contribution paid into the EU budget in the May-December 2004 period., see: "Polska w Unii Europejskiej" [Poland in the European Union], ... op.cit., p. 37.

Latvia					
2003/2002	1.9	-1.7	8.4	8.0	6.4
2004/2003	46.8	38.5	11.4	21.4	56.8
Jan. – Apr. 2004/Jan. – Apr. 2003	26.1	8.3	10.7	18.6	49.1
May – Dec. 2004/ May – Dec. 2003	56.1	52.7	11.8	22.7	60.1
Poland					
2003/2002	9.1	6.2	9.3	10.0	14.2
2004/2003	35.0	41.5	22.8	23.0	24.2
Jan. – Apr. 2004/Jan. – Apr. 2003	25.5	24.1	21.9	22.8	28.0
May – Dec. 2004/ May – Dec. 2003	39.0	48.7	23.2	23.1	22.6
Slovenia					
2003/2002	5.3	4.9	1.3	2.0	7.1
2004/2003	17.3	19.5	9.6	9.4	8.6
Jan. – Apr. 2004/Jan. – Apr. 2003	13.2	12.8	4.8	6.0	14.9
May – Dec. 2004/ May – Dec. 2003	19.1	22.5	12.1	11.2	5.7
Slovakia					
2003/2002	26.4	59.4	26.9	21.9	10.4
2004/2003	16.7	12.0	13.5	15.2	19.9
Jan. – Apr. 2004/Jan. – Apr. 2003	27.6	65.4	18.6	15.9	8.6
May – Dec. 2004/ May – Dec. 2003	12.5	-3.4	11.2	15.0	25.1

Source: Table compiled by Aleksandra Bujnowska based on Eurostat data

A similar tendency was observed in exports to the EU-15 countries, although export growth rates were somewhat lower than those recorded in trade within the EU-10 group, while in the case of two countries (Slovakia and Estonia), the increase in exports in 2004 was slower than in the previous year.

Exports to third countries (who were not EU members) were also rising faster in 2004 than in the previous years, as well as faster than in the months directly preceding accession. This could imply that EU entry has made it possible for the new member states to obtain easier access to some third markets, such as the markets of the CIS countries (mainly Russia and Ukraine) or the markets of countries that have preferential trade agreements with the EU (Turkey, Israel and the Maghreb countries).

The acceleration of exports from the new member states was mainly caused by the abolition of remaining intra-EU trade barriers after May 1st, 2004 (conditional protection instruments, barriers to agricultural trade and physical barriers in the form of complex border control procedures), which has facilitated an increase in sales, particularly to other new member countries. Another factor contributing to the increase in the growth of exports was the rapid increase in import demand in Russia, which remains a significant export market for the countries of Central and Eastern Europe and the Baltic States. Most importantly, the sizeable increase in exports to the markets of the "old" EU countries took place in an environment of very slow growth in domestic demand in these countries, which indicates that companies from the new member states turned out to be very competitive under the liberalised trading conditions.

In all of the analysed countries, the growth of imports in 2004 turned out to be even faster than that of exports, reaching on average 20%-35% annually in euro terms (Table 5.2.). This was the case both for imports from other new member states, as well as for imports from the countries of the old “fifteen”. Meanwhile, imports from third countries were rising at a notably slower pace – in fact, most of the new member countries experienced a decline in imports from third countries (with the exception of Hungary and, in particular, Latvia). This could suggest that EU accession has caused a strong “trade diversion effect”, from previous sources of imports to increased purchases in EU member countries. However, the decline in imports from third countries did not affect significantly the overall high rate of growth of imports from new member countries, as the share of third countries in total imports in this group of countries does not at present exceed 20%.

Table 5.2. **Changes in the level of imports of new EU member states (annually, as % of change of volume in euro terms)**

	From outside EU–15	From outside EU–25	From EU–15	From EU–25	from EU–10-
Czech Republic					
2003/2002	9.9	10.9	4.0	4.5	7.2
2004/2003	-0.4	-13.9	37.9	37.4	34.4
Jan. – Apr. 2004/Jan. – Apr. 2003	13.7	13.6	10.0	10.6	13.9
May – Dec. 2004/May – Dec. 2003	-7.2	-27.6	51.2	49.9	43.5
Estonia					
2003/2002	24.5	26.5	4.4	6.6	18.6
2004/2003	5.4	-12.1	28.4	34.0	61.1
Jan. – Apr. 2004/Jan. – Apr. 2003	28.7	28.6	12.3	15.1	29.0
May – Dec. 2004/May – Dec. 2003	-5.2	-30.9	35.8	42.6	75.4
Hungary					
2003/2002	8.8	7.7	3.5	4.8	14.7
2004/2003	5.6	1.2	18.8	19.9	28.1
Jan. – Apr. 2004/May – Dec. 2003	24.1	23.4	5.6	8.0	27.6
May – Dec. 2004/ May – Dec. 2003	-2.6	-9.0	25.0	25.5	28.4
Lithuania					
2003/2002	9.1	8.8	4.8	5.9	10.4
2004/2003	14.6	-3.1	17.3	31.0	85.1
Jan. – Apr. 2004/Jan. – Apr. 2003	9.9	-6.1	30.4	41.4	86.2
May – Dec. 2004/May – Dec. 2003	16.8	-1.6	12.1	26.9	84.6
Latvia					
2003/2002	12.8	17.1	4.0	5.5	8.7
2004/2003	31.0	22.2	13.5	22.1	40.1
Jan. – Apr. 2004/Jan. – Apr. 2003	30.3	29.4	17.6	21.9	31.3
May – Dec. 2004/May – Dec. 2003	31.4	18.7	11.8	22.1	43.6
Poland					
2003/2002	4.7	3.8	2.3	2.9	8.6
2004/2003	6.1	-0.8	26.8	27.7	35.1
Jan. – Apr. 2004/Jan. – Apr. 2003	19.3	16.6	19.3	20.6	31.4
May – Dec. 2004/May – Dec. 2003	0.0	-9.0	30.3	31.0	36.8

Slovenia					
2003/2002	8.1	9.0	4.6	4.7	5.6
2004/2003	4.2	-0.5	17.2	17.3	17.8
Jan. – Apr. 2004/Jan. – Apr. 2003	13.6	17.7	7.7	7.0	1.7
May – Dec. 2004/May – Dec. 2003	-0.5	-9.6	21.9	22.3	25.8
Slovakia					
2003/2002	11.1	8.8	16.1	15.6	14.3
2004/2003	18.6	-3.1	19.3	27.1	45.8
Jan. – Apr. 2004/Jan. – Apr. 2003	15.0	10.5	19.6	20.0	21.0
May – Dec. 2004/May – Dec. 2003	20.3	-9.6	19.2	30.1	56.3

Source: Table compiled by Aleksandra Bujnowska based on Eurostat data

The fast growth of imports was on one hand the result of a notable acceleration of economic growth in nearly all the new member states (with the exception of Lithuania, where GDP growth in 2004 turned out to be slightly lower than in 2003, although it was still very high – 6% – and considerably higher than in most of the remaining countries in the region), and on the other was due to increased purchases associated with the anticipation by importers of changes in some of the market conditions in association with EU accession (increases in VAT rates on some goods and increases in prices of some products). Another factor acting in support of imports was the abolition of border controls between the new member countries and the countries of the "15", which has greatly facilitated international trade.

As a result of the faster growth of imports compared to that of exports in all the new member states, foreign trade balances have deteriorated (with the exception of Lithuania), although the situation in different countries was quite diverse in this respect (Table 5.3.). Three of the countries – the Czech Republic, Hungary and Slovakia – saw a sizeable decline in their surplus in trade with the EU-15 countries. A particularly large change was observed in the Czech Republic, where the trade surplus in 2004 was five times lower than that recorded in the previous year, mainly as a result of very fast growth of imports from countries of the "old Union" (by around 37%). The remaining countries saw a deepening in their traditional deficits in trade with the EU-15, sometimes quite sizeable (e.g. in Poland the commodity trade deficit increased from 4.2 billion to 6.6 billion euros). The only exception in the group is Lithuania, where the trade deficit was subject to a small decline.

Table 5.3. **Foreign trade balance of the new member countries in trade with the EU 15 and with third countries (in millions of euro)**

	With EU–15	With third countries
Czech Republic		
2003	3 127.7	-5 802.8
2004	659.2	-1 344.6
Estonia		
2003	-339.7	-1 397.3
2004	-954.7	-1 000.5
Hungary		
2003	4 808.3	-8 975.5
2004	3 521.6	-7 118.9

Lithuania		
2003	–1 117.0	–1 250.7
2004	–1 050.7	–1 372.8
Latvia		
2003	–774.8	–1 295.1
2004	–912.2	–1 542.9
Poland		
2003	–4 182.8	–8 644.5
2004	–6 621.6	–4 890.1
Slovenia		
2003	–1 637.5	683.6
2004	–2 426.8	1 328.2
Slovakia		
2003	1 468.4	–2 074.2
2004	1 064.7	–2 610.9

Source: Table compiled by Aleksandra Bujnowska based on Eurostat data

The opposite tendency was observed in foreign trade with other countries. Most of the new member states experienced an improvement in their trade balance, sometimes a very sizeable one, such as in the case of the Czech Republic (improvement by 4.5 billion euros) and Poland (improvement by 4.7 billion euros).

All the new member states were expected to be net receivers of funds from the European Union budget from the very first months of their membership. The balance of transfers was expected to be positive for them, as amounts of structural (and pre-accession) funds received by these countries were expected to be on average twice as high as the contributions they paid into the EU budget. There is no full statistical data available yet on the final balance of flows to the new member states in 2004. Initial figures indicate that the majority of countries have indeed recorded a positive balance of transfers. For example, in the case of Poland, the surplus of funds received from the EU over the membership contribution is estimated at around 1.5 billion–1.6 billion euros. Hungary is an exception to this rule, as initial figures point towards a negative balance of transfers in 2004. The balance of transfers and its size depend mainly on the capacity of individual countries to absorb them, while these in turn depend on the quantity and quality of submitted investment projects, the capacity to provide co-financing, as well as the ability of local governments to prepare applications for financing in line with EU procedures.

Agriculture is without a doubt the sector that benefited the most in the first year of membership. The profitability of agricultural production has increased notably in nearly all the new member states, with the biggest improvement taking place in Poland (from –1.6% in 2003 to 8.2% in 2004) and Lithuania (from –6.7% to 4.4%, respectively). Hungary is once again the exception, as the profitability of agricultural production declined there from 0.1% to –13.9%. The changes in profitability were mainly driven by changes in the prices of food products after May 1st, 2004. Benefits were reaped mainly by those countries in which pre-accession price levels were lower than on EU markets. The improvement in the financial situation of farmers and the rural areas was not only due to an increase in the prices of food products and an improvement in the profitability of production, but also a consequence of the direct subsidies they received. This affected Poland and the Baltic States to the largest extent. In Poland there were 1.5 million farms that benefited from the subsidies, in Lithuania 290,000 and in Latvia 85,000, while in the Czech Republic and Slovakia there were 21,000 and 17,000, respectively.[4] These disparities are mainly due to the different structures of agriculture in different countries.

It is also worth noting that thanks to EU membership, programmes for the development of the rural areas were drafted (with funds allocated for their implementation from the EU budget, as well as domestic co-financing). Programmes were also prepared for many other sectors of the economy, especially the infrastructure and environmental protection, as well as programmes for all regions. The preparation of these programmes was a prerequisite to applying for aid from the EU budget. Adoption by the poorer new member states of EU cohesion policy principles has created an opportunity for a significant increase in investment in fixed assets and in human capital (through various forms of training), i.e. the key factors of production.

The main negative effects of accession include, first of all, an increase in consumer prices, especially of some food products, although it should be noted that this increase was not only associated with accession, but also with other factors. The main causes were the increase in consumption expenditure in the months directly preceding the accession date, caused by fears of price increases, hikes in global prices of natural resources and fuels caused by the acceleration of economic growth in China and India, and increases in VAT and excise tax rates on some goods and services (e.g. building materials). Only two new member countries (Slovakia and Slovenia) saw prices rise at a slower pace in 2004, than in the previous year.[5]

Three countries in the region – Estonia, Lithuania and Slovenia – entered the ERM-II exchange rate mechanism in June 2004, directly after their EU accession. This was possible due to their low budget deficits (under 3% of GDP), the stable condition of public finances and the stability of their domestic currencies. In the case of the Baltic States, a decisive role in this regard was played by their currency board arrangements, which have been maintained in the ERM-II. This would open the opportunity for these countries to join the euro zone as early as in mid-2007, provided that they fulfil the nominal convergence requirements. The remaining countries in the region are not yet prepared to enter the ERM-II, mainly because of sizeable fluctuations in the exchange rates of their domestic currencies and large budget deficits.

5.1.2. The terms of cooperation between the European Union and the Russian Federation

a) Enlargement of the European Union and its relations with Russia

The enlargement of the EU has led to temporary tensions in relations with Russia, which claimed that the enlargement would affect negatively its exports to the new member states, as well as the economy of the Kaliningrad District. For this reason, it had been delaying its consent for the new member states to be covered by the terms of the Agreement on Partnership and Cooperation, which has been regulating the relations between Russia and the EU

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4 Rzeczpospolita, July 15, 2005

5 See: Polityka gospodarcza Polski w integrującej się Europie 2004–2005. Raport roczny [Poland's economic policy in the integrating Europe 2004–2005. Annual report], J. Kotyński (ed.), IKCHZ Warsaw 2005, p. 37–39.

since the beginning of December 1998.[6] A compromise between the EU–15 and Russia on this issue had only been reached a few days before the date of enlargement, namely on April 27th, 2004. At the same time, in order to limit the negative consequences for suppliers from third countries and buyers in the new EU member countries arising from the inclusion of the latter in the EU's common trade policies, the Commission introduced transitory solutions for some goods (mostly for anti–dumping measures). In practice, this meant that the accession of the new member countries to the EU did not generally lead to a deterioration of access to their markets.[7]

A factor that led to a deterioration of the terms of cooperation and the overall sentiment in Russia's relations with the new member states was the introduction by Russia in mid–2004 of the requirement for these countries to submit their meat, fish and dairy processing plants to inspections conducted by Russian veterinary services and obtain new veterinary certificates. Russia introduced such a requirement, even though the Central European companies exporting to Russia usually had EU certificates (confirming compliance of their products with the high EU requirements). Russia made its consent for exports of products by Polish companies, for example, to its territory conditional on the results of these inspections.[8]

The decision to introduce new documents required from foreign suppliers selling to Russia was motivated by fears of an increased (after enlargement) inflow of food products from the EU. The very long duration of the inspections conducted by Russian veterinary authorities in the new member states and, as a result, the halt and then decline of exports to Russia, suggest that the purpose of the inspections was to limit the imports of agricultural–food products from the new member states, rather than just to monitor them. The situation was particularly difficult as concerns exports from Poland. After many months of the exchange of arguments by the two parties, it was finally agreed that the new EU member countries would introduce the new export certificates for animal products as of January 1st, 2005. As of April 1st, 2005, Russia also introduced the requirement of unified phytosanitary certificates for suppliers from the EU for horticultural products. The delays in inspections of Polish facilities, as well as the new Russian requirements concerning export certificates, negatively affected the size of Polish exports to Russia of goods covered by the new regulation. Despite these obstacles, the value of all exports of agricultural–food products to Russia increased considerably in 2004. This trend was particularly evident in

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6 Russia argued that the enlargement of the EU would significantly constrain its ability to export to its traditional markets in the countries of Central and Eastern Europe, which were to join the EU, as well hinder cooperation in other areas. Therefore, it addressed a number of demands to the EU. It sought, among other things, an improvement in the terms on which it was to export goods to the enlarged EU, as well as the abolition of visas for its citizens in transit travel to Kaliningrad, which had become an enclave, surrounded by EU member states. For more information, see: E. Kawecka–Wyrzykowska, Integration of the Central and Eastern European Countries with the European Union and EU Relations with Russia, w: New Europe. Report on Transformation. XIV Economic Forum, Krynica, 9–11 September 2004, Eastern Institute, Warsaw 2004.

7 The EU also raised quotas for imports of steel products from Russia, taking into consideration the traditional Russian deliveries to the markets of the new member states. See: Skutki przyjęcia przez Polskę wspólnej polityki handlowej UE, w: Polska w Unii Europejskiej [The consequences of adoption of the EU's common trade policy by Poland, in: Poland in the EU], E. Kawecka–Wyrzykowska and E. Synowiec (ed.), volume II, IKCHZ, p. 108–136.

8 The new Russian requirements applied to all EU countries, but they were particularly acute for many Polish companies, due to the large significance of their sales to the Russian market.

the case of horticultural products, which did not require new certificates.

Generally speaking, the significance of economic cooperation with the European Union to Russia, in particular as regards international trade, increased notably after EU enlargement. The EU became the largest market for Russian goods (more than 50% of Russian exports are now sold on this market). At the same time, following the enlargement, Russia is the fifth largest trading partner of the EU, after the U.S., Switzerland, China and Japan. This strong trade interdependency of the two partners should be conducive to finding a better legal–institutional framework for future cooperation.

b) The results of the May 2005 EU–Russia summit

The main platform for discussion about the terms and conditions of various forms of cooperation, economic, political, scientific, etc., between Russia and the EU are the "summits" of Russian and EU leaders, usually taking place twice a year.

On May 10th this year, another, 15th, Russia–EU top level summit took place in Moscow.[9] Discussions there led to the drawing up of so–called "road maps",[10] meaning programmes for tightening cooperation in four areas ("common spaces"); the economy, internal security, external security, and culture, education and science. The actual wording of these agreements was finalised only a few hours before the beginning of the summit. The reason was the lack of compromise even for the generic clauses that prevail in the documents. The main point of contention was the issue of the abolition of visas between Russia and the EU, which was the most important objective of the Russian side. The Russians were seeking until the very last moment to obtain some concessions on the part of the EU, but eventually had to give up.[11]

The four separate **"road maps"** are extensive in terms of their volume (each of the documents consists of several dozen pages), yet they are very generic and declarative in terms of their content. They consist of political declarations by the two sides, which need to be filled in with specific arrangements.[12] They should be treated more as a set of wishes

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9 EU–Russia Summit, Moscow, May 10th, 2005, Conclusions, http://www.europa.eu.int/comm/external_relations/russia/intro/index.htm

10 This term was introduced in order to set these documents apart from the action plans agreed with countries that participate in European neighbourhood policies. It is worth noting that a declaration on working towards the achievement of four "common spaces": economic, freedom, security and justice, external security and training and scientific research, was adopted at the EU–Russia summit in St Petersburg on May 31st, 2003, It was partly the result of the fact that Russia did not express interest in participating in the European Neighbourhood Policy. The parties did agree, meanwhile, that special action plans ("road maps") would be drawn up, which would give more specific meaning to the idea of four "common spaces".

11 The main problem is that Russia does not want the agreement on readmission, i.e. taking back illegal immigrants, who are stopped at the EU–Russian border, to cover citizens of third countries, who would be entering the EU through Russia. Meanwhile, the EU makes its consent to the abolition of the visa requirement or even the easing of visa requirements conditional on Russia's concurrence to admit back all persons illegally crossing the border.

12 Despite the generic nature of these documents, their preparation aroused controversy between the partners. One of the contentious issues was the number of documents. The EU had initially wanted a single document to be drawn up, but eventually it acquiesced to the Russian request for four "road maps" to be signed, making up a single package. However, it had not agreed for these documents to be adopted successively. The EU project for the whole package was ready by April 2004, but it was not possible to finalise it before the summit of May 2004, as Russia raised a number of amendments and reservations regarding the draft.

for the two sides, rather than a list of binding commitments.

Concerning **the Common Economic Space**, the two sides agreed that cooperation would above all cover such issues as the protection of intellectual property, improvement of the investment climate, the development of financial services, satellite navigation, environmental protection, etc. The objective is to create an "open and integrated market between the EU and Russia",[13] and as a result abolish barriers to trade and investment. These declarations are sometimes interpreted as a prelude to negotiations on creating a free trade zone. The document also foresees the strengthening of cooperation in a number of areas, such as telecommunications, transport and environmental protection, which should make it easier to fulfil the Kyoto Protocol commitments.

The Common Space of Freedom, Security and Justice was one of the most difficult to agree on. Finally, the two sides declared that they would continue negotiations on the liberalisation of visa requirements and an agreement on readmission, as well as look into the possibility of introducing full visa-free movement between Russia and the EU, but in a "long-term perspective." The document does not feature a timetable for the gradual abolition of visas by the year 2008, which Russia had sought during the negotiations on the text. Despite prior objections by the Russians, the text does feature a reference to "common values", including democracy, the rule of law, human rights and a free media. Among other issues covered by the ongoing dialogue, the two sides also listed closer cooperation in fighting terrorism, organised crime, money laundering and the trade in drugs and humans.

In the area of the **Common Space on Research, Education and Culture**, the EU and Russia listed such issues to be covered by mutual dialogue and cooperation, as harmonisation of their education systems in line with the principles of the Bologna process, Russia's participation in the Erasmus project, increased youth exchange, and the promotion of cultural projects. It was also agreed to create a European Institute in Moscow in 2006, to be co-financed by the EU and Russia.

In **the Common Space of External Security** "road map", the two partners pointed to opportunities for cooperation in such areas as the non-proliferation of weapons of mass destruction, the control of exports of weapons, and preparation for cooperation in crisis management operations. Russia did not agree to a clause saying that the two sides should cooperate particularly in their "common neighbourhood", and this was replaced by a more generic statement about "regions located close to the borders" of Russia and the EU. At the same time, the EU did not agree to adopt a clause on military-technical cooperation (including possible joint production of military equipment). The EU will continue providing humanitarian aid.

At this year's summit, the EU also confirmed its support for the Russian bid to join the WTO (the details of a bilateral agreement setting the conditions for improved access of EU firms to the Russian market had been adopted a year earlier, during the summit of May 2004).[14]

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[13] http://www.europa.eu.int/comm/external_relations/russia/intro/index.htm

[14] The EU is not satisfied with all the conclusions. It was particularly interested in faster abolition of fees charged by Russia for flights by European aircraft over Siberia. In 2004, Russia had agreed to abolish the fees by 2013, which effectively means that until the year 2012 nothing will change. See: E. Kawecka-Wyrzykowska, Integration of the Central and Eastern European Countries ... op.cit.

Despite the lack of progress on the issue of the abolition of visas, the results of the summit have been perceived by both sides as a step forward. However, this is an unduly optimistic assessment, more reflective of the hope for more specific decisions in the future, rather than the actual deepening of existing cooperation. As noted earlier, the "road maps", although covering a broad range of issues, are tentative and the prospects for their practical implementation on a broad scale in the near future do not appear to be good. Specifically, they do not envisage the creation of an appropriate institutional framework and specific instruments for the achievement of the objectives put forward.

A positive assessment is warranted, however, when comparing the results to those of the previous summit (in November 2004), at which it was not possible to come to practically any agreement at all.

The brief overview of the "road maps" presented above evidently shows that these documents are extremely generic. They feature very few concrete decisions that would make a fresh contribution to existing forms of cooperation between Russia and the EU. They are at best a framework for future, more specific, decisions. The fact that these documents were only agreed upon just before the meeting of the leaders of the two sides indicates that there are still significant differences in views on many issues in Russia–EU relations.[15]

If these persist in the coming months, they could negatively impact the negotiations on a more favourable legal framework for cooperation. An opportunity for setting a new framework for cooperation could arise soon, with the expiration in 2007 of the first, 10–year term of the Partnership and Cooperation Agreement (PCA). The agreement could of course be extended on the same terms, but another option would be for the new agreement to envisage more favourable terms of cooperation (e.g. some preferential treatment). This issue could be of additional significance to Russia, if it turned out that the EU is willing to make its new PCA with Ukraine a more favourable one than that which expires four months after Russia's PCA.

5.1.3. The terms of cooperation between the European Union and Ukraine[16]

Similarly as in the case of Russia, the EU's institutional cooperation with Ukraine in recent years has been developing within the framework of the PCA.[17] It envisages regular meetings at the highest level. The "Orange Revolution" and the election of President Viktor Yuschenko are new determinants of mutual relations. EU membership has been put forward as the strategic goal of Ukraine's activities in the near future. President Yuschenko made this very clear during his first visit to EU institutions and the European Council at the beginning of 2005.[18]

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[15] M. Menkiszak, Commentaries, Eastern Studies Centre, www.osw.waw.pl/pub/koment/2005/02/050224a.htm

[16] P. Wołowski, Commentaries, Eastern Studies Centre, www.osw.waw.pl/pub/koment/2005/02/050224a.htm

[17] On March 30th, 2004, a Protocol was signed extending the EU–Ukraine PCA onto the new EU member states.

[18] EU membership was also said to have been the strategic objective of president Kuchma's administration, but this position was not definite, as it did not prevent president Kuchma from signing in the spring of 2004 an agreement with Russia, Belarus and Kazakhstan on creating a Common Economic Area.

EU leaders are being very careful in promising closer institutional ties with Ukraine. They emphasise their sympathy for political change, declare their support for the policy of the further tightening of political and economic ties with Ukraine, but at the same time indicate that the European Neighbourhood Policy (ENP), presented in its first version in the spring of 2003,[19] will remain the cornerstone of mutual relations. It envisages a tightening of the EU's ties with its Eastern and Southern neighbours after the most recent round of enlargement, in order to increase stability and security for all cooperating participants and the "emergence of new dividing lines between the enlarged EU and its neighbours".[20] A significant element of this policy is the increased financial support (under the name "European Neighbourhood and Partnership Instrument" — ENPI) that will be available beginning from 2007 and which will replace – in the case of Ukraine and other CIS countries – the TACIS programme.

On February 21st, 2005, an EU–Ukraine Action Plan was signed, as an instrument of the implementation of the European Neighbourhood Policy.[21] It had been agreed with Ukraine's previous government, back in 2004. As a result of the "Orange Revolution", the plan now includes some more promising, although still rather generic, statements, as regards the possibility of bringing Ukraine closer to the European Union. The Action Plan covers a number of specific issues related to various areas of the functioning of the state, in which Ukraine should adjust to EU standards or international requirements. These include recommendations concerning, among other things, the strengthening of democracy and the rule of law, reforming the legal and justice system, effective combating of corruption, ensuring freedom of the media, liberalisation of the economy and foreign trade, and cooperating with the EU on foreign policy and security issues. The fulfilment of these recommendations should allow Ukraine to "gradually enter increasingly closer relations [with the EU], surpassing cooperation, in the direction of gradual economic integration and the deepening of political cooperation." However, the Action Plan does not include any prospect for Ukraine's membership of the EU, which is what the country is most interested in.

As a result of the political changes in Ukraine, the EU has also complemented the Plan with a 10–item programme for deepening cooperation with that country. It includes a list of measures designed to support the reform process and bring Ukraine closer to the EU. In view of the costs that Ukraine will have to incur in order to complete many of the changes necessary to conduct a real transformation of its economic and political system, the EU has offered to increase financial support from its budget, as well as to grant up to 250 million euros in favourable loans from the European Investment Bank.[22]

The EU is also committed to the immediate start of consultations on an agreement on close cooperation that would replace the Partnership and Cooperation Agreement (PCA), expiring in 2008 (this would most likely be a more favourable agreement than the PCA). The

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19 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, Brussels, 11.03.2003, COM (2003) 104 final.

20 http://www.europa.eu.int/comm/world/enp/policy_en.htm

21 It was adopted at the meeting of the EU Council at the level of foreign ministers, shortly before the visit of President Yuschenko to European institutions, which took place on January 31st, 2005.

22 According to European Commission figures, EU support as part of the TACIS programme and many other initiatives (including the closure of the Chernobyl nuclear plant) amounted to a total of 838 million euros in the years 1998–2004, with 128 million euros paid in 2004, see: http://www.europa.eu.int/comm/external_relations /ukraine/intro/index.htm

EU has also discussed the possibility of granting Ukraine the status of a country with a market economy[23] and supporting Ukraine's efforts to join the WTO. In another area important to Ukraine – the easing of visa requirements – the EU has mentioned the possibility of introducing less stringent procedures for some groups of Ukrainian citizens. However, this is under the condition that progress is made in negotiations on the agreement on readmission.

On May 12th, 2005, the European Commission announced its decision to increase EU support for the fund financing the closure of the Chernobyl power plant by 49 million euros.[24] This means that the total amount of aid provided for this purpose by the EU since 1997 will reach almost 240 million euros. The EU is the main donator to this fund. The closing of the Chernobyl plant, in line with international safety standards, is one of the objectives agreed upon in the above-mentioned Action Plan.

Ukraine's unilateral declarations addressed to the European Union are much more ambitious. Speaking before the European Parliament in Strasbourg at the beginning of 2005, President Viktor Yuschenko deemed the Action Plan an important stage of cooperation with the EU, but he also stated very clearly that the neighbourhood policy was not satisfactory for Ukraine and was not a sufficient basis for mutual relations. "The aim of my country, the main goal of my government and me personally is for Ukraine to join the European Union", Yuschenko declared openly. He also added that he would like the Action Plan to result in the signing of an agreement on Ukraine's association with the EU and the fastest possible initiation of negotiations on accession to the EU – ideally in 2007.[25] During the press conference, President Yuschenko sketched a possible timeline for his country's path towards the EU; first obtaining from the EU the status of a market economy (May 2005), then finalising negotiations on Ukraine's entry into the WTO (November 2005) and then initiation of negotiations on a free trade zone and the liberalisation of visa requirements for selected groups of Ukrainian citizens. At the same time, he declared that the realisation of strategic goals, including the preparation of accession to the EU, would be supported by a programme of reform of the Ukrainian state – the transformation of the economy into a social market economy, a change in the way power is executed in the country, the separation of business from politics, fighting corruption, limiting of the shadow economy, macroeconomic stability and embracing factors of economic growth.

The reaction of the EU leaders to all these declarations was – as already mentioned – a chilly one from the very beginning. The political impasse in which the EU has found itself since the rejection of the Constitution Treaty in June 2005 in referenda in France and the Netherlands and after the failure of June's European Council devoted to the discussion

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[23] Based on a European Council decision of October 2002 (Council Regulation (EC) No. 2238/00 amending Regulation (EC) NO. 384/96 on protection against dumped imports from countries not members of the European Community, OJ L 257, 11.10.2000) the status of a market economy could only be granted to selected Ukrainian enterprises, meeting a set of requirements (one of which is that the prices for their goods are to be set using a market mechanism, rather than an administrative one by government institutions). The status of a market economy gives Ukrainian exporters better protection in anti-dumping proceedings, which in the past had been initiated against Ukrainian goods on a number of occasions.

[24] The fund was created in 1997 and it is being managed by the European Bank for Reconstruction and Development.

[25] The same priorities of Ukraine's foreign policy were listed by President Yuschenko before, on January 25th, 2005, during his speech to the European Council.

of the EU Financial Plan for the years 2007–2013, has created an additional obstacle and pushed back in time the possibility of further enlargement of the EU, including the initiation of accession negotiations with Ukraine.

This does not make it easier for Ukraine to undertake a more decisive programme of market reforms and push through necessary, but costly, economic and political reforms, which would bring the country closer to the economic and political standards of the European Union. Without a clear programme of closer institutional and economic ties between Ukraine and the EU, even if such a plan was to have a long–term character, it would be difficult for Ukraine's leaders to convince the society at large and the elite to undertake unilateral, costly adjustment to EU political and legal solutions. This in turn could imply the possibility of Ukraine returning to closer political, institutional and economic ties with Russia.

5.1.4. European Union's relations with Belarus

The mutual relations between the EU and Belarus are still governed by the Agreement on Economic Cooperation and Trade between the EEC and USSR, signed in December 1989. On March 6th, 1995, the EU and Belarus signed a Partnership and Cooperation Agreement, similar to those negotiated with most of the countries that emerged after the break–up of the USSR. However, this agreement never came into effect due to political factors; the failure of the administration of President Lukashenka to abide by the principles of democracy and political freedom. This situation also makes it impossible to include Belarus in the EU's New Neighbourhood Policy, under which the provision of EU aid to neighbouring countries is conditional upon their respecting of human rights, the rights of minorities and other democratic freedoms.

However, the EU does support financially the development of a civic society in Belarus, as well as some technical and regional programmes. In the years 1991–2004, this assistance amounted to 221 million euros.[26]

5.1.5. Sectorial agreements of the EU with CIS countries

In connection with the accession of new member states, in the spring of 2004, the European Union announced that quotas for goods covered by sectorial arrangements, imported from some CIS countries, would be raised. This applied to two groups of goods; textiles and clothing imported from Belarus and steel products imported from Russia, Ukraine and Kazakhstan.[27] Prior to their accession, the new member states were not limiting imports from these countries, whereas afterwards, they adopted EU regulations.

In order for the terms of the foreign trade between the CIS countries and the new member countries not to deteriorate, the EU raised its quotas on textiles and clothing for 2004 (by the average value of imports of acceding countries in the years 2000–2002, adjusted proportionally for the period of eight months). The EU announced this decision on March 17th, 2004.[28] The

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26 http://www.europa.eu.int/comm/external_relations/belarus/intro/index.htm#overview

27 E. Kaliszuk, Ograniczenia ilościowe, w Polska w Unii Europejskiej, [Quotas, in: Poland in the European Union], E. Kawecka–Wyrzykowska and E. Synowiec (ed.)... op.cit.

28 Council Regulation no. 487/2004 from March 11th, 2004, amending the Regulation (EEC) no. 3030 on n common rules for imports of certain textile products from third countries (OJ L 79 from 17.03.2004, p. 1).

agreement with Ukraine only envisages the monitoring of imports from that country (quotas had been abolished after 1998). Meanwhile, the existing quotas have been extended to December 31st, 2005 on imports from Belarus – which was influenced by the political situation in that country. As a result, Belarus is the only country, next to Serbia and Montenegro and North Korea, in relation to which the EU applies quotas on imports of textiles and clothing (quotas on imports of textiles from Vietnam have been suspended since April 1st, 2005).[29]

Steel quotas are in place, based on bilateral agreements between the EU and Russia, Ukraine and Kazakhstan. The legal basis for raising them in connection with the EU enlargement was a relevant clause on the possibility of renegotiation of the size of quotas in the event of EU enlargement. On May 4th, 2005, the European Commission and the Ukrainian government reached an agreement concerning a new steel agreement for the years 2005–2006. It envisages an extension of quotas for steel goods imported from Ukraine.

5.1.6. Final remarks

The accession of five Central European countries and the three Baltic States to the European Union has opened up for them new opportunities for economic, as well as other, cooperation, both within this group, as well as with the EU15 member countries. In the area of trade exchange, the abolition of border controls in the trade of goods allows the introduction of the freedom of movement of goods across the whole European Union, as well as the elimination of the possibility of the use of so-called contingent protection measures by countries of the "15". An additional factor freeing up the trade in agriculture-food products was the elimination of the customs barriers that existed before accession and for some goods – also non-customs ones. The size of the market that is governed by uniform requirements and regulations has increased notably. This is a basis for companies to achieve economies of scale and thus improve their international competitiveness. The various financial support programmes are also very significant, as they allow production and service companies to conduct additional investment and strengthen their market position.

The enlargement has also resulted in – albeit to a limited extent – modification of the terms of trade of the new EU member countries with the CIS countries. This was mainly associated with the adoption by the new EU member states of the principles and instruments of common trade policy, as well as other solutions from EU legislation. These changes affected almost exclusively imports from the CIS countries, as exports to these countries are mainly determined by their internal trade policies. The changes in the terms of imports were not large; they had no significant impact either on the volume of trade between the new EU member countries and CIS countries, or on other areas of economic cooperation.

A clear increase in the volume of trade between the new EU member countries and Russia was observed in 2004. It is something of a paradox that this increase occurred despite persistently chilly relations between the two sides (this is particularly the case for Russia's relations with Poland and the Baltic States). This would suggest that economic cooperation is increasingly independent from politics. However, in the longer run, the lack of a good political climate could have a negative impact on trade, particularly that associated with capital investment, large trade contracts or projects that can be partly financed with EU funding.

[29] Textile quotas in imports from other countries have been abolished, either based on the Textile Agreement agreed during as part of the Uruguay GATT round (in force since 1995) or unilaterally.

5.2. REGIONAL ECONOMIC COOPERATION BETWEEN THE CIS COUNTRIES AND CENTRAL AND EASTERN EUROPE

Economic cooperation in the region has continued to be concentrated on two centres – the European Union and the CIS. Similarly to previous years, the process of regional integration within the Commonwealth of Independent States has been moving forward at a very slow pace. Despite the signing of a number of declarations and agreements, attempts to tighten reciprocal relations among the countries in the region have hardly found any reflection in trade statistics. Russia is not abandoning further integration efforts, although the democratic changes in Georgia and Ukraine, as well as the pro-Western orientation of the Moldovan government, have cast a shadow of doubt over the possibility of further tightening of the economic ties among the CIS countries.

The latest initiative aimed at developing the cooperation among the countries created after the breakdown of the Soviet Union is the Common Economic Area of Russia, Ukraine, Belarus and Kazakhstan. Intensive efforts are currently under way to prepare documents that would allow for the implementation of this plan, although in many cases these have met resistance from the Ukrainian authorities, who do not want to undertake initiatives that would negatively affect the country's integration with the European Union. It also appears that cooperation within the Eurasian Economic Community, despite the change of power in Kyrgyzstan, has undermined the implementation of important integration decisions taken at the beginning of this year.

The eight most developed countries of Central and Eastern Europe, who became full-fledged EU members on May 1st, 2004, had continued their reciprocal cooperation based on previously agreed principles right until the moment of accession. Five countries (the Czech Republic, Poland, Slovakia, Slovenia and Hungary) have been cooperating as part of the multilateral CEFTA agreement, and the Baltic States, as part of the trilateral Baltic Free Trade Agreement (BAFTA). Meanwhile, trade cooperation between each of the above-mentioned five countries with each of the Baltic States was regulated by bilateral free trade agreements. Upon these countries' EU accession, all these agreements ceased to apply, while trade between all eight countries became subject to the rules of the single European market. At the same time, the new member states adopted all the instruments and principles of EU trade policy with regard to trade with third countries, which, among other things, implied a change of the terms of cooperation with current CEFTA countries (Bulgaria, Croatia, and Romania).

The Central and Eastern European countries' drive to their strategic objective of entering the EU has had a significant impact on the development and strengthening of their interregional ties. The creation of CEFTA in particular had clearly been inspired by the EU and had been viewed as a step along these countries' path to the EU. CEFTA, as well as BAFTA, have proved useful instruments for the liberalisation of trade among the countries participating in them, as well as a unique "test" of the ability of future EU members to cooperate among one another. The eight countries' entry to the EU structures should make it easier for them to participate in further and faster integration in many areas.

5.2.1. Regional cooperation of the Commonwealth of Independent States members

The first agreement on the tightening of cooperation among the countries created after the break–up of the USSR was signed on December 8th, 1991, i.e. on the day of the signing of the Białowieża accords, which put the final seal on the break–up of the USSR. The objective of the then–created Commonwealth of Independent States was to facilitate the process of transition from a uniform state to twelve autonomous economic systems, particularly through the development of cooperation in the area of foreign policy, the creation of a single economic area, and of common transport and communications systems.[30]

Despite a great number of agreements and declarations, the integration processes within the CIS have largely been limited to the functioning of preferential trade agreements (and this with some exceptions), with some elements of a free trade area. During the period of systemic transformation, the share of intraregional trade in the overall trade of each country declined notably, which was largely associated with the transition of these countries to trading in world prices and conducting settlements in convertible currencies, as well as the application in their trade of the principles of double taxation and numerous customs fees, the failure of companies and government institutions to settle their liabilities, poor contractual discipline, the weakness of domestic currencies and instability of exchange rates, and high risk.[31] In recent years, in most cases, the share of the CIS countries in trade of individual members was subject only to minor changes (see Table 5.4.), which could indicate a certain stability of trade relations. An important feature of the economic relations among the CIS countries is their continuing bilateral nature.

Table 5.4. **Share of CIS countries in the trade exchange of individual countries of the Commonwealth in the years 2002–2004 (as %)**

Country	**Exports**			**Imports**		
	2002	**2003**	**2004**	**2002**	**2003**	**2004**
Armenia	19	19	17	31	22	23
Azerbaijan	11	13	17	39	32	34
Belarus	55	55	53	69	70	72
Georgia	49	49	51	39	33	36
Kazakhstan	23	23	20	46	47	48
Kyrgyzstan	35	35	38	55	57	62
Moldova	54	54	51	39	42	43
Russia	15	15	16	22	23	24

[30] The decision on the creation of the CIS had been undertaken by the leaders of Russia, Ukraine and Belarus of that time. Soon afterwards, on December 21st, 1991, Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan and Uzbekistan also joined, followed by Georgia in 1993. Among the former Soviet republics, only the Baltic States – Lithuania, Latvia and Estonia – did not participate in cooperation within the CIS, having opted for integration with the West and joined the European Union on May 1st, 2004.

[31] Торгово–экономические отношения России со странами СНГ, „Внешнеэкономический комплекс России в начале нового тысячилетия: тенденции и перспективы развития", ВНИКИ, Moscow 2002, p. 203.

Tajikistan	26	17	17	76	68	70
Turkmenistan	n.a.	46	n.a.	n.a.	49	n.a.
Ukraine	24	26	26	47	50	51
Uzbekistan	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Interstate Statistical Committee of the CIS (www.cisstat.com).

There are a number of causes of the failure of such broad economic integration within the area of the countries created after the break-up of the Soviet Union, of both a political, as well as an economic, nature.[32] They also include the charge that from the very beginning of the CIS's existence, Russia, which is the dominant member and one whose views determine the nature of the integration processes taking place within the CIS, did not offer a project that would be attractive to the other members of the organisation and as a result has practically deprived itself of any influence over the individual countries. It is also significant to note that the implementation of decisions taken within this organisation is not obligatory and a number of agreements and accords that have been signed are no longer of any significance, are no longer valid, or their implementation would have been irrational.

The growing criticism of the effects of the CIS's activities and of the reason for its existence, has led the member countries, in particular Russia, to undertake steps aimed at reforming the CIS and strengthening the economic cooperation taking place within the alliance. Some of these changes go in the direction of strengthening the power of decisions taken, improving the mechanisms of economic integration and its further development on terms that would be favourable for all parties to the agreement.

Despite the undertaken reform efforts, when it comes to economic integration, the CIS remains a rather loose union of the countries of which it consists. However, some transformation of its nature may be observed, as under the influence of Russia the CIS is increasingly evolving into a political organisation. As a result of new threats and challenges, CIS cooperation is increasingly focused on combating international terrorism and extremism, security issues and police cooperation. Initiatives in this area include, for example, the creation of the CIS Anti-terrorism Centre in Moscow and the adoption of the decision on the implementation of an international programme of joint measures to control crime in the years 2005–2007.

Cooperation on humanitarian and human rights issues is also becoming a significant area of cooperation within the CIS. In May 2005, CIS leaders adopted the Declaration on Humanitarian Cooperation, which envisages the possibility of signing a relevant agreement on this issue. Cooperation in this area is expected to cover the issues of culture, national tradition, language, science, public education, information and the mass media, sport, tourism and youth movements.

The Commonwealth of Independent States, which remains the broadest integration initiative in the post-Soviet area, is often perceived as an instrument for upholding Russian influence over this area. This assessment is partly justified, but it should also be noted that the initiation of cooperation among the countries created after the break-up of the Soviet Union appears to be a natural development, when taking into account that these countries have been functioning as part of one economic entity for many years.

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[32] More on this in: *New Europe. Report on Transformation. XIV Economic Forum Krynica*, D. Rosati, (ed.) Eastern Institute, Warsaw 2004, p. 227–228.

The difficulties associated with economic integration within as broad a structure as the CIS, have led Russia to initiate other, narrower, cooperation agreements within the post-Soviet area. The most advanced of these is the Belarus and Russia Union State, which features elements of a customs union and a common market or even an economic union. This structure has so far succeeded in achieving a relatively high level of integration as concerns economic issues, defence and security, anti-terrorism measures and crime prevention, as well as in the area of migration policy and ensuring equal rights for citizens. The union is also making headway with preparations for a currency union, joint price policy and harmonisation of tax legislation, as well as with work on a common economic, scientific-technical, education and information area. In April 2005, the two countries made a decision on conducting a joint foreign policy of the union state, while the key objectives for 2005 included the following; harmonisation of customs and tax procedures, continuation of the process of currency integration, and continuing to bring closer the economic systems of the two countries, in all aspects.[33]

The statements by representatives of the two countries indicate that the process of building a Union State is progressing, although it is relatively slow. Assessments by independent politicians are less optimistic, particularly considering that the most recent changes are hardly impressive. They put particular emphasis on the delay of the date for the introduction of the Russian rouble as the only legal means of tender in Belarus, which was meant to precede the introduction of a new common currency on the territory of the Union State. The date for the realisation of this objective had initially been set for January 1st, 2005 and then put back to January 1st, 2006. At present, even the latter date appears to be unrealistic for technical reasons, as according to experts, the introduction of the rouble in Belarus would require a preparation period of at least six months, while the final decision on this move has yet to be made. What is more, the presidents of the two countries have recently been avoiding setting specific deadlines for the fulfilment of this objective. There is not even a date set for linking the two currencies of Belarus and Russia, even though originally this was expected to take place on July 1st, 2004.

The readiness to undertake integration decisions in subsequent areas and, consequently, the pace at which the Union State is being built, largely depend on the temperature of the political and personal relations between the leaders of the countries. It seems that in the most recent past, the political will for bilateral integration between the two countries has subsided somewhat, evidenced by almost the full year that has passed since the last meeting of the Supreme Council of the Union State, which makes key decisions concerning the integration of the two countries.

In this situation, it became necessary to offer arguments that would justify successive setbacks in the process of the introduction of the common currency. Hence, increasingly often the authorities of the two countries can be heard declaring the need for further work on unification of the normative-legal basis, the resolution of a number of problems in the area of monetary and credit policy, exchange rate policy and foreign exchange market regulation, the payment system, banking supervision and organisational-technical ventures. The main

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[33] Within the Union State, there are still outstanding differences in the regulatory-legal framework, which greatly hampers cooperation between Belarusian and Russian companies. The most significant limitations are present in regulations concerning customs, taxes, non-tariff constraints and foreign currency regulations.

issue of contention precluding an agreement on this matter, however, continues to be that of the central bank and the size of the compensation that Belarus would receive in return for surrendering its own currency. Negotiations on both these issues are still underway, although Russia did offer to compensate Belarus for the budget losses associated with the introduction of the common currency, arising as a result of the unification of the tax systems and the conversion of budget liabilities from the currency of Belarus to that of Russia. However, Russia has no intention of compensating Belarus for the budget losses resulting from abandoning the previous principle of VAT being charged in the country of origin, nor for price increases introduced by Russian companies in association with the change in the principles for the collection of this tax.

Another obstacle preventing the final decision on the date of introduction of the Russian rouble in Belarus, are the differences in views on the issue of the best date for the introduction of the common currency. In the opinion of the authorities in Belarus, such a decision should be the final stage of the economic and political integration of the two countries, which can only yield an additional economic effect, if issues related to the creation of a single economic and customs area and an equal environment for companies from both countries, are resolved beforehand. The Russian side is of a different view, claiming that the introduction of the rouble as a common currency is possible even prior to the resolution of other issues and will not have any negative consequences for the two countries' economies.

An important event in the bilateral relations between the two countries was the change in the system of VAT collection on goods exported and imported between Russia and Belarus. A relevant "Russia–Belarus agreement on the principles of the collection of indirect taxes on exports and imports of goods, services and work performed" from September 15th, 2004, foresaw a change in the mode of the collection of indirect taxes to the principle of the buyer country,[34] which was associated with the implementation of decisions taken during the summit of the heads of countries of the Common Economic Area (see below) in Astan in September 2004.

The enactment of these decisions led to two types of problems. Firstly, Belarusian exporters put their shipments to Russia on hold, in fear of the untimely settlement of indirect taxes by the Russian recipients, and secondly, Russian suppliers refused to deliver goods to Belarus without VAT, which led to an increase in the prices of Russian imports. Only after an information campaign, conducted at the beginning of January 2005, did the negative effects of this change subside somewhat; shipments of goods from Belarus to Russia were resumed and many Russian suppliers ceased to overcharge for goods supplied to Belarus by including VAT on them.

The situation was particularly difficult when it came to supplies of oil and natural gas, which play a significant role in the strengthening of Belarus–Russia relations.[35] Since the beginning of the transformation period, Russia has been supplying energy resources to Belarus at prices lower than that dictated by the world market. A case in point is the supplies of Russian gas, exported to Belarus at an unchanged price level since January 1st, 2004. As a result of the implementation of the above-mentioned agreement, the prices of Russian

34 Russia's shift to paying indirect taxes in the destination country, particularly in the case of trade in oil and gas, initially concerned all the other CIS countries with the exception of Belarus. Countries of the "distant abroad" were settling their taxes in the same manner.

35 Price increases also affected imports of other groups of goods.

gas for final recipients increased by 18%. This of course became a pretext for President Lukashenka to claim that Russia has failed to apply the principle of equal gas prices within the Union State.

In anticipation of changes in the prices of oil and gas, which would be unfavourable for Belarus, Russia granted a special loan to the tune of US$175 million to Belarus at the end of 2004. However, there is a high likelihood that these funds have been devoted to other uses, such as price increases, assistance provided to students or mothers with small children, and to appease the society after the falsification of the results of the referendum on changes in the constitutions.

The use of cheap Russian loans and subsidies and allowances (used in trade in oil and natural gas) by Belarus to achieve political goals and maintain an ineffective economic system is being met with increasing dismay in Russia. In the context of the creation of currency union and bringing the economies of the two countries closer together, many Russian economists are going so far as to claim that the economy of Belarus – inefficient, centralised and largely controlled by the state – would only be an unnecessary and troublesome burden for Russia.

According to research conducted by experts with the International Monetary Fund, Belarus is unable to function separately from Russia. Due to the inflexibility of the government sector (80% of the economy), it is unprepared for the limiting of support from Russia in the form of the supply of energy resources at prices lower than present on world markets. Furthermore, a customs union with Russia and lower labour costs allow Belarus to achieve a competitive advantage on the Russian market, maintain the country's export specialisation dating back to the times of the Soviet Union, and increase exports of finished industrial products (e.g. trucks and household appliances) to Russia.[36]

In view of this, the promise made by President Vladimir Putin to freeze the price of gas sold to Belarus in 2006 at the level of 2005, is a crucial one. This would be possible under the condition that Belarus does not increase the price for the transit of Russian gas and speeds up work on preparing an agreement for the long-term lease of land for Gazprom pipelines. However, there are some doubts as to whether the realisation of these promises will be possible in the light of Russia's commitments to the WTO, as well as Gazprom's declaration on the intention to raise wholesale gas prices.[37]

Next to the Belarus and Russia Union State, another important integration initiative in the CIS area is the Eurasian Economic Community (EEC). This structure was created in October 2000 by Russia, Belarus, Kazakhstan, Kyrgyzstan and Tajikistan, while Ukraine, Moldova and Armenia have obtained an observer status in the organisation. The EEC has well-defined economic objectives. The community features a free trade area and multilateral projects, mainly in the energy and transport sectors. Work is also advancing gradually on creating a common customs area with common external borders. As indicated by a document adopted by the Community, "Priority Development Directions for the Eurasian Economic Community for 2003-2006 and the Following Years", the introduction of a customs union in this area is to be prepared by the end of 2006.

During the meeting of EEC member countries in March 2005, it was decided to complete in 2006 the process of harmonisation of customs duties, the efficiency of which is assessed

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[36] *Торгово–экономические отношения*..., op. cit., p. 197.

[37] Comp. O. Языкович, Сказано–Сделано?, „Национальная Экономическая Газета" of 19.04.2005.

by experts at 60% to 90%, for various items. The most recent integration measures were also aimed at introducing uniform rates for railway transport, ensuring visa-free movement of citizens, consultations on foreign exchange, agriculture and food processing policies, coordination of activities on international markets (*inter alia* working out common negotiation positions for WTO accession talks) and the resolution of the issue of the migration of the labour force.

The March meeting of heads of state of the EEC countries brought approval for the policy outline in the area of the agriculture-food industries of these countries, as well as the signing of several technical documents, including an agreement on conducting a commonly-agreed policy on the creation and development of transport corridors, as well as on the harmonisation of technical guidelines, along with a protocol on the introduction of changes and an addendum to the agreement on customs and tax inspections in the production and trade in ethyl spirits, alcohol products containing spirits and tobacco products within the territory of the EEC countries. However, the realisation of decisions made in March 2005 is now surrounded by some doubt, as shortly after the declarations were adopted, a change of government took place in Kyrgyzstan.

According to representatives of the Russian authorities, the most promising directions for cooperation among companies from the EEC countries include the electricity and energy sector, the fuel and energy sector and the high technology sector. However, the intensification of this form of cooperation would require substantial support from the state, including the preparation of government programmes for financing this form of cooperation. It is worth noting here that cooperation within the Eurasian Economic Community is not only a result of economic considerations, but is also associated with non-economic threats of long-term nature, such as terrorism or Islamic extremism.

In the recent past, Russia has been quite hopeful of the prospects for a new integration initiative, namely the agreement on the creation of the Common Economic Area (CEA). This agreement envisages the establishment of a free trade zone, a customs union and a common market (including the assurance of the free flow of goods, services, capital and labour), as well as the harmonisation of tax, credit and exchange rate-financial policies. A relevant agreement concerning these issues was signed by Russia, Belarus, Ukraine and Kazakhstan on September 19th, 2003, and ratified by the national parliaments of these countries in April 2004. A high-level group for the establishment of the CEA has been created, composed of representatives of the countries involved, at the level of deputy prime minister.

Work on documents facilitating the implementation of this agreement has been undertaken relatively fast. A number of documents have already been prepared and signed, such as; the concept of the establishment of the CEA, the set of basic instruments for the creation of the CEA and a technical plan for the implementation of these instruments.

As part of the process of the creation of the CEA, the preparation and signing of 85 agreements is envisaged. Twenty-nine of them are considered priority agreements, as their adoption is meant to facilitate the creation of a free trade area and ease the regulations on the flow of individuals between countries participating in this initiative.[38] The first stage of

[38] In April 2005, Ukraine put forward a proposal on limiting the number of agreements to 16 and additionally including an agreement on the trade in services in the priority group. At the same time, the Ukrainian authorities refused to sign agreements on the uniform terms of transit and uniform nomenclature of international activities of the CEA countries.

the realisation of the agreement envisages, first of all, the adoption of uniform regulations concerning the determination of the country of origin of goods from third countries, the use of tariff quotas, and the licensing of imports and exports, as well as the unification of the rules of competition policy and the collection of indirect taxes in reciprocal trade. The list of key documents also includes agreements concerning the application of special protection, anti-dumping and compensatory measures in reciprocal trade, the simplification of the procedures for customs clearance and the control of internal borders, investment activity, and the terms of transit through the territory of the countries participating in the establishment of the CEA. In addition, the possibility of the gradual or one-time abolition of export and import customs rates in reciprocal trade is being looked into.

Work is also underway on the creation of a mechanism for working out common views in conducting negotiations on WTO membership. According to already-approved documents, in the event that one member is accepted into the WTO, it should then act in favour of the admission of the other members as soon as possible and refrain from coming up with new demands with regard to these members, during the negotiation process. Issues related to the completion of infrastructure projects, which are in the sphere of interest of all the CEA countries, particularly those related to the transport of energy resources, are also currently under discussion.

In addition, agreements are also being prepared concerning such issues as the visa-free movement of people, a simplified border crossing procedure for means of transport, income migration, and the harmonisation of regulations concerning the transport of foreign currencies by individuals crossing borders between countries participating in the establishment of the CEA.

The preparation of drafts of the relevant agreements has been assigned to seven working groups; (1) customs-tariff policy, (2) competition policy and policy in the area of public purchases and granting of subsidies, (3) technical policy and intellectual property, (4) tax, budget, monetary-credit and exchange rate policy, (5) policy in the area of services), (6) policy on capital flows and investment, and (7) the movement of individuals. A special expert-organisational group is in charge of the coordination of the work of the working groups.

The process of creating a new integration structure is advancing exceptionally smoothly, although at the turn of 2004/2005, work slowed down somewhat, due to the decision of the Ukrainian government to review the documents prepared by the previous government from the viewpoint of their compliance with Ukrainian legislation and the country's strategy of integration with the EU.

It is hard to assess what actual results this closer cooperation will bring, particularly since there are significant differences in the attitude of individual countries towards the CEA. It is no secret that Ukraine does not accept the CEA project as a whole and is only interested in creating a free trade area,[39] and that only under certain conditions. These are the amendment of the agreement on the establishment of the CEA, in particular the removal of the clauses on the creation of supranational bodies and the establishment of equal representation in all bodies and the application of the principle of consensus in decision-making (rather than weighing countries' power by their economic potential). In addition, Ukraine wants the

[39] Particularly since Ukraine's current constitution does not allow the country's authorities to enter a customs union.

free trade area to be established by the end of 2005, but with no exceptions (exclusions) or limitations. This would imply total abolition of export duties, exceptions from the free trade principles as concerns customs duties and import quotas, and total abolition of all protection measures (anti-dumping, compensatory and special). The fulfilment of this demand is particularly difficult in view of the similar economic structures of the countries. The overall decline in output and de-industrialisation of the economies of countries created after the break-up of the USSR, had led during the transformation process to a decrease in the share of highly-processed goods in total output and an increase in the share of raw materials and low-processed goods. This has resulted in an increase in reciprocal cooperation both on the markets of third countries and within the CIS. In an effort to protect its own producers, Russia is waging trade wars, frequent particularly against Kazakhstan and Ukraine.[40]

A factor limiting Ukraine's involvement in the new integration initiative is its drive to create a free trade area with the EU and join the World Trade Organisation (WTO). While Ukraine's new authorities are not abandoning cooperation within the CEA, they are treating this organisation more as a temporary solution. It is also worth noting that the countries involved in creating the CEA do not intend to speed up the process of integration at all costs, but are seeking to secure their interests appropriately. In addition, it cannot be excluded that the CEA will become yet another initiative undertaken only by governments, with little involvement on the part of the business circles.

When discussing the development of integration initiatives in the CIS area, it is also important to mention GUUAM – a structure created by Georgia, Ukraine, Azerbaijan and Moldova in October 1997, and joined by Uzbekistan in April 1999. This organisation has been virtually inactive for several years, but the democratic changes that have taken place in Georgia and Ukraine, the pro-Western turn in Moldova's policies, as well as the accompanying meetings of the leaders of these countries, have resulted in numerous calls for its reactivation.

The GUAM organisation was created with the support of the United States as a counterweight for Russia's dominance in the CIS area, but also with the aim of ensuring the continuity of supplies of Caspian and Central Asian oil to Western markets, bypassing Russia's pipelines and ports. The main objective of this organisation was the development of economic-political and military cooperation. However, these objectives were being fulfilled only to a limited degree, while the development of transport corridors bypassing Russia became the main objective. The key project is TRACECA, a multi-transport corridor, encompassing a Eurasian pipeline running from the Caspian oil reserves through Azerbaijan and Georgia, on to the Black Sea, and onwards through the Odessa-Brody pipeline to Europe, via road and rail arteries.[41]

It seems that in the near future, economic cooperation within the GUUAM framework is not likely to gain significant momentum, particularly when considering that countries with such limited economic potential have relatively poor chance of achieving mutually beneficial integration. For the time being, meetings of the leaders of the countries participating in this organisation tend to have a political character and are a forum at which the willingness to conduct changes is being declared. For example, during the GUUAM summit that took place in Kishinev in April 2005, the leaders of Georgia, Ukraine, Azerbaijan and Moldova discussed the issues of the development of democracy in the former USSR countries and the

[40] *Торгово–экономические отношения…*, op. cit., p. 204.

[41] More on this in: *New Europe. Report on Transformation…*, op. cit., p. 232.

opening up to European countries, and announced a declaration on democracy, stability and development, in which they confirmed their commitment to European and Euro-Atlantic integration, and to the principles of democracy and European values.

The revival of cooperation within GUUAM could lead to the emergence of a political and economic bloc of countries seeking to partly loosen their ties with Russia and heading towards integration with the Euro-Atlantic and European structures. Ukraine would undoubtedly assume the position of a regional leader as an alternative to Russia, as its economic potential is second to Russia among the CIS countries. In the future, GUUAM could become a platform for regional cooperation among the EU's eastern neighbours, covered by the European neighbourhood policy and striving to deepen integration with the European Union.[42]

The tightening of cooperation among Ukraine, Georgia and Moldova is often viewed as an attempt to demonstrate their independence of Russia and as the "nail in the coffin" of the Russia-dominated Commonwealth of Independent States. However, actions taken by the Ukrainian authorities point to their desire to maintain relations with Russia, particularly in the area of economic cooperation. This could be evidenced for example by the meeting of President Yuschenko with representatives of Russian business that took place in March 2005. The aim of this meeting was to convince the companies that Ukraine was an attractive place to invest and that it was interested in the inflow of capital from Russia. The president pledged to representatives of Russian business above all to improve the investment climate, including the political climate and the tax system, so that it was more attractive for business.

President Yuschenko's plans to help revive reciprocal relations also include the easing of regulations concerning border crossings between Ukraine and Russia and Belarus. Thanks to the introduction of amendments to bilateral agreements on visa-free movement, it would become possible to travel between these countries using domestic passports. To this end, talks are also planned on the creation of joint border checkpoints and the separation of a lane for passenger cars, buses and cars of diplomatic representatives, as well as reducing the number of documents required for customs and border inspections.

5.2.2. Cooperation between the countries of Central Europe and the Baltic States

The strategy of integration with the European Union pursued by CEFTA and the Baltic States, the possibility of importing modern technologies, products and services from this direction, as well as expanding their exports to the geographically close and traditionally important EU markets, are reflected in these countries' strong involvement in trade with the EU.

The eight countries of Central and Eastern Europe that obtained European Union membership on May 1st, 2004, have been able to redirect the geographical structure of their foreign trade towards the West relatively quickly, in the first years of transformation, while the high share of the EU-15 in their overall exports and imports were subject to minor fluctuations in the recent past. In 2003, the most significant of the countries among the 15 in terms of

[42] See: J. Wróbel, *Szczyt GUUAM w Kiszyniowie*, [GUUAM Summit in Kishinev] Commentaries of Eastern Studies Centre, on 28.04.2005 Ukraine and Moldova have been included in this policy from its very beginning, while Georgia and Azerbaijan were included in it from June 2004.

exports were Hungary, the Czech Republic and Poland, while on the side of imports, they were Slovenia, Poland and the Czech Republic (Table 5.5.).

Table 5.5. **The share of EU–15 and reciprocal trade in the foreign trade turnover of the new EU member countries from Central and Eastern Europe in 2003 (as %)**

Country	Exports			Imports		
	EU–15	reciprocal	combined (2+3)	EU–15	reciprocal	combined (5+6)
1	2	3	4	5	6	7
Czech Republic	69.8	16.4	86.2	59.1	12.1	71.2
Estonia	58.4	14.1	72.5	51.9	10.0	61.9
Lithuania	53.2	18.5	71.7	44.5	11.3	55.8
Latvia	61.8	17.4	79.2	51.0	24.3	75.3
Poland	68.8	11.9	80.7	61.1	7.9	69.0
Slovakia	60.6	23.6	84.2	51.4	22.3	73.7
Slovenia	58.4	8.5	66.9	67.3	8.3	75.6
Hungary	73.6	7.5	81.1	55.0	7.9	62.9

Source: Own calculations based on Direction of Trade Statistics Quarterly, IMF, Washington, March 2005.

It is worth noting that among the eight above-mentioned countries, only in the case of Slovenia was the share of the EU–15 in its overall exports lower than in imports, with such a relationship observed since the second half of the 1990s. In the case of the remaining countries, the share of exports is clearly higher than that of imports, with the largest discrepancy recorded in Hungary.

The inflow of foreign direct investment into the eight new member countries, largely from the EU–15, has had a significant impact on the development of these countries' trade ties with the EU. The share of the European Union in total direct foreign investment attracted by these countries (according to figures as of the end of 2003) was the highest in the case of the Czech Republic (85.0%), Estonia (84.5%) and Poland (82.8%), followed by Hungary (79.4%), Slovakia (77.2%),[43] Slovenia (65.7%), Lithuania (63.0%) and Latvia (55.0%).[44] Entities with foreign ownership are playing a significant role in the foreign trade turnover of these countries. For example, in the case of Poland, the share of companies with foreign capital in total exports amounted to 54.5% in 2003, while that in imports, to 58.2%.[45] In the case of the Czech Republic, these indicators amounted to 53.0% and 47.3%, respectively.[46] Meanwhile, in Hungary, in the year 2000 entities with foreign ownership accounted for around 73% of the country's total exports, while in 2002 this share was as much as 10 percentage points

[43] Data covers a group of six countries – the largest direct investors from the EU–15.

[44] Based on data from National Banks of these countries, with the exception of Lithuania (data of the Statistics Department of the Lithuanian Republic).

[45] Inwestycje zagraniczne w Polsce. Raport roczny, [Foreign investments in Poland. Annual Report] Foreign Trade Research Institute, Warsaw 2004.

[46] Own calculations, based on figures from the Czech National Bank and the Czech Statistical Office.

higher.[47] It is also worth emphasising the significant role of companies with foreign capital in the development of the exports of these countries – the higher level of international competitiveness of these companies and their products have had a certain impact both on the product structure of exports, as well as on their growth rate.

Compared to the volume of trade with the EU–15 countries, the scale of reciprocal trade between the eight analysed countries is clearly more modest. Slovakia stands out from the other countries, with its exports to the remaining seven countries amounting in 2003 to 23.6% of its overall exports, whereas for imports this proportion amounted to 22.3% (Table 5.5.). This is directly related to Slovakia's extensive economic ties with the Czech Republic, dating back to the period when these countries were parts of a single state. The Czech Republic is Slovakia's second largest trading partner (after Germany), both in exports and in imports (in 2003 the share of the Czech Republic amounted to 12.9% and 14.3%, respectively). The relatively high share of reciprocal trade in the total volume is also observed in the case of Latvia, which in turn is a consequence of its strong economic ties with the other two Baltic States. In 2003 (similarly to 2004), Lithuania and Estonia were the fourth and fifth largest recipients of Latvian goods (after the UK, Germany and Sweden), while Latvia was the second (after Germany) and Estonia the fourth (after Russia) supplier of goods to the Latvian market. Lithuania and Estonia accounted for 14.8% of Latvia's total exports in 2003 and 16.1% of its imports. Meanwhile, among the countries of the eight, the lowest ratios of reciprocal trade in global turnover were observed in Hungary, Slovenia and Poland.

A comparison of the streams of reciprocal trade of the eight analysed countries points to the concentration of their exports and imports in two or possibly three recipient countries (Tables 5.6. and 5.7.). In the case of the Czech Republic, Slovakia, Poland and Hungary, the main trading partners in terms of both exports and imports are the same countries. In the case of the Czech Republic it is Slovakia, for Slovakia, the Czech Republic; for Poland, the Czech Republic and for Hungary, Poland. In the case of Slovenia, Poland is the main export partner, while the Czech Republic is the main import partner. It is also worth noting that while the exports of the respective Baltic States are mainly directed to themselves; on the import side Poland is an important supplier for them (in the case of Lithuania, the largest).

Table 5.6. **Geographical structure of reciprocal exports of the new EU member countries from Central and Eastern Europe in 2003 (as %)**

	Czech Rep.	Estonia	Lithuania	Latvia	Poland	Slovakia	Slovenia	Hungary
Czech Rep.	x	0.7	2.7	1.0	29.2	48.5	4.0	13.9
Estonia	3.5	x	28.7	52.9	6.9	0.6	0.1	7.3
Lithuania	2.0	23.3	x	52.3	18.2	0.7	0.1	3.4
Latvia	2.8	37.9	47.2	x	8.6	1.9	0.5	1.2
Poland	34.1	2.7	20.8	5.6	x	13.7	2.8	20.3
Slovakia	56.4	0.4	0.8	0.7	20.2	x	3.6	17.9
Slovenia	21.5	0.6	3.2	1.6	32.6	17.1	x	23.4
Hungary	27.3	1.5	2.4	1.1	30.0	26.6	11.0	x

Source: Own calculations based on Direction of Trade Statistics Quarterly, IMF, Washington, March 2005.

47 Data of the Hungarian Economy and Transport Ministry.

Table 5.7. **Geographical structure of reciprocal imports of the new EU member countries from Central and Eastern Europe in 2003 (as %)**

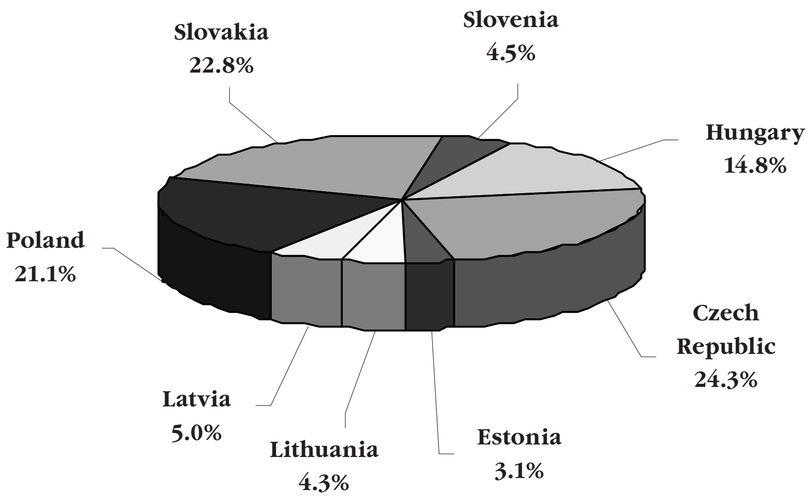
	Czech Rep.	Estonia	Lithuania	Latvia	Poland	Slovakia	Slovenia	Hungary
Czech Rep.	x	0.5	0.5	0.2	34.3	42.8	4.9	16.8
Estonia	10.0	x	28.5	23.9	24.9	2.8	1.4	8.4
Lithuania	13.3	12.3	x	14.1	45.8	3.7	3.1	7.7
Latvia	5.8	26.4	39.9	x	21.0	2.6	1.1	3.2
Poland	43.4	1.1	5.7	0.8	x	19.4	7.0	22.6
Slovakia	66.9	0.1	0.2	0.2	15.0	x	3.2	14.5
Slovenia	30.2	0.2	0.3	0.3	18.6	15.9	x	34.5
Hungary	30.2	1.5	1.3	0.2	34.9	24.6	7.3	x

Source: Own calculations based on Direction of Trade Statistics Quarterly, IMF, Washington, March 2005.

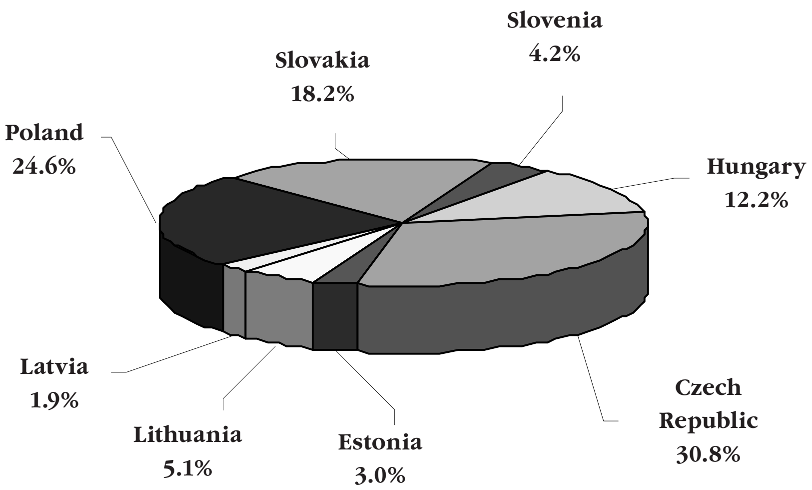
The Czech Republic, Poland and Slovakia dominate the reciprocal trade of the eight analysed countries, with the Czech Republic and Poland more involved on the export, rather than the import, side (see Figure 5.1.). Together, these three countries accounted for almost 74% of reciprocal exports of the eight countries in 2003 and over 68% of imports. They are followed by Hungary in terms of significance, while Slovenia and the three Baltic States play a clearly smaller role in reciprocal trade, which is largely a consequence of their economic potential.

Figure 5.1. **The share of the EU–8 countries in their reciprocal trade in 2003**

Import



Export



Source: Based on Direction of Trade Statistics Quarterly, IMF, Washington, March 2005.

The development of trade volume was the main form of reciprocal cooperation among the eight countries of Central and Eastern Europe. Their foreign direct investment activity was limited, mainly as a result of their limited capital resources. As a result, interregional foreign direct investment could not have stimulated reciprocal trade as strongly, as was the case for businesses with Western capital.

Foreign direct investment attracted by individual countries from the group usually accounted for a negligible share of total FDI inflows observed in these countries. Only in the case of Slovakia, Lithuania and Latvia was the significance of direct investors from this group of countries clearly higher (Table 5.8.). Hungary was the sixth and the Czech Republic the seventh largest foreign investors in Slovakia. Meanwhile, Estonia was ranked sixth in such a comparison both in Lithuania, as well as in Latvia.

Table 5.8. **Foreign direct investment (*inward stock*) in the new EU member countries from Central and Eastern Europe, as of the end of 2003**

Country	Total FDI (in euro mil.)	FDI from CEE–7 (in euro mil.)	Share of CEE–7 in total FDI (as %)	Share of the respective investor countries from the CEE–7 in total FDI (as %)	
Czech Rep.	35 852.0	599.4	1.67	Slovakia	1.12
				Hungary	0.32
				Poland	0.13
				Slovenia	0.10
Estonia	5 163.6	33.7	0.65	Latvia	0.34
				Lithuania	0.26
				Hungary	0.04
Lithuania	3 967.6	482.6	12.16	Estonia	8.40
				Poland	2.03
				Latvia	1.55
				Czech Rep.	0.11
				Hungary	0.07
Latvia	2 665.2	206.7	7.75	Estonia	6.89
				Lithuania	0.71
				Poland	0.07
				Czech Rep.	0.06
Poland	43 827.4	167.3	0.38	Hungary	0.19
				Slovenia	0.08
				Czech Rep.	0.07
				Slovakia	0.04
Slovakia[a]	8 422.0	861.3	10.21[b]	Hungary	5.15
				Czech Rep.	5.06
Slovenia	5 069.7	140.0	2.78	Czech Rep.	2.36
				Hungary	0.37
				Latvia	0.03
Hungary[a]	33 202.2	23.3	0.07	Slovenia	0.03
				Czech Rep.	0.03

[a] Basic capital + reinvested profits

[b] Data covering only Hungary and Czech Republic

Source: Own calculations based on data from National Banks of analysed countries, with the exception of Lithuania (data of the Statistics Department of the Lithuanian Republic).

The largest amounts of foreign direct investment from the other partner countries (as of the end of 2003) were absorbed by the economies of Slovakia, the Czech Republic and Lithuania, with the bulk of this capital being invested by the neighbouring countries. It is worth noting the minimal level of foreign direct investment by countries of the region in Hungary.

In the case of direct investments made by the eight countries abroad, the significance of partner countries in the geographical structure of the investments is clearly higher than in the structure of the overall amount of attracted FDI (Table 5.9.). Almost ľ of all capital invested abroad by Estonia has been directed to Lithuania and Latvia, while more than half of such investment by Slovakia has been absorbed by three neighbouring countries, mainly the Czech Republic. Meanwhile, Hungary, the Czech Republic and Estonia are the largest regional investors in the eight countries, with Hungary and Estonia standing out as net exporters of foreign direct investment to the other partner countries.

Table 5.9. **Foreign direct investment (*outward stock*) of the new EU member countries from Central and Eastern Europe as of the end of 2003**

Country	**Total FDI (in euro mil.)**	**FDI to CEE–7 (in euro mil.)**	**Share of CEE–7 in total FDI (as %)**	**Share of the respective investor countries from CEE–7 in total FDI (as %)**
Czech Rep.	1 807.8	653.5	36.1	Slovakia 30.1 Slovenia 3.6 Poland 2.0 Hungary 0.4
Estonia	809.6	593.5	73.3	Lithuania 44.7 Latvia 28.2 Poland 0.4
Lithuania	95.7	22.3	23.3	Latvia 13.0 Estonia 8.9 Poland 0.7 Czech Rep. 0.7
Latvia	84.0	.	.	.
Poland	1 494.9	65.1	4.3	Czech Rep. 2.6 Lithuania 1.5 Hungary 0.1
Slovakia[a]	443.7	225.8	50.9[b]	Czech Rep. 40.5 Hungary 6.1 Poland 4.3
Slovenia	1 848.9	141.4	7.6	Poland 5.3 Czech Rep. 1.0 Slovakia 0.8 Hungary 0.5
Hungary[a]	2 566.3	718.1	28.0	Slovakia 28.1 Czech Rep. 3.2 Poland 2.3 Slovenia 0.7

[a] Basic capital + reinvested profits

[b] Data covering only Hungary and Czech Republic

Source: Own calculations based on data from National Banks of analysed countries, with the exception of Lithuania (data of the Statistics Department of the Lithuanian Republic).

Future investment cooperation between the eight countries in the form of direct investment, will be determined both by the amount of the capital available to potential investors, as well as investment strategies. In searching for the paths of future development, businesses whose financial position will be increasingly strong, could exhibit a greater willingness to invest abroad, including in partner countries of the region. An example of this is the 400 million euros acquisition of a 62.99% stake in Czech company Unipetrol by Polish oil firm PKN Orlen, finalised in May 2005, which was one of the largest transactions between countries of Central and Eastern Europe. The acquisition of Unipetrol has strengthened the position of the Polish company in its rivalry with, among other firms, MOL of Hungary and Austria's OMV, for leadership in this part of Europe. Smaller companies are also pursuing cross-border investment projects. For example, Polish juice producer Maspex took another step in this direction by making an acquisition in Hungary at the end of 2004, having previously invested in the Czech Republic, Slovakia, Romania and Russia (Kaliningrad). It is believed that the European Union membership of the eight countries of Central and Eastern Europe should be conducive to their cooperation in the form of foreign direct investment, but it will have a far greater significance for their foreign trade volume.

The EU accession of the eight countries has implied the abolition of borders to trade between them and the EU-15 countries since May 1st, 2004, as well as between themselves. Trade within the common EU market is taking place without any limits whatsoever. The change in the terms of trade primarily affected the trade in food and agricultural products, as trade in industrial goods had not been constrained by customs barriers even before EU enlargement. This was the case both for trade with the EU-15 countries (based on European Agreements), as well as for their reciprocal trade, taking place as part of CEFTA (the Czech Republic, Poland, Slovakia, Slovenia and Hungary) and BAFTA (Estonia, Lithuania, Latvia), as well as bilateral free trade agreements between each of the five CEFTA countries of the time and each of the three Baltic States.

A significant change for the EU member countries (aside from the abolition of customs duties and non-tariff constraints in trade) was also the abolition of physical barriers on their mutual borders, which has directly caused the shortening of transport times and the reduction in the costs of delivering goods to the markets of EU countries.

An initial assessment of the results of foreign trade in the new EU member states for the year 2004, suggest a favourable impact of EU accession on their overall trade volume. In 2004, the average rate of growth of the exports of the ten new member countries amounted to more than 20% (in euro terms) and was almost three times as high as the average for the EU-15. The highest rates of export growth (according to Eurostat figures) were observed in Poland and the Czech Republic (around 27% and 26%, respectively), as well as in the Baltic States – Latvia (24%), Lithuania and Estonia (both around 21%).[48] The lack of comprehensive figures does not permit a detailed analysis of the directions of trade of the EU-8 countries. According to some assessments, the growth of the reciprocal trade of these countries was higher than that of their exports to the EU-15.[49] It should be noted in this context that exports to the EU countries in 2004 were taking place against the background of unfavourable cyclical conditions in the countries of the 15, whereas the relatively high rate of economic

[48] Eurostat, Euro-Indicators. News Release, 42/2005 – 25 March 2005.

[49] One year on. The impact of EU enlargement, Economist Intelligence Unit, May 2005.

growth and import demand in the CEE–8 countries has had a positive impact on reciprocal trade.

Following the accession of the eight Central and Eastern European countries to the EU, only one of the two previously existing structures of trade cooperation, CEFTA and BAFTA, still exists, namely CEFTA. However, it is now limited to only three members (Croatia, Bulgaria and Romania), all of which joined the agreement later than its founding members (the Czech Republic, Poland, Slovakia, Hungary and Slovenia), first Romania (July 1st, 1997), followed by Bulgaria (January 1st, 1999) and Croatia (March 1st, 2003). Participation in CEFTA has been considered a step along each of these countries' path towards European Union membership.

Among the current CEFTA countries, the highest share taken by the EU in trade volume is observed in Romania, whereas the relative significance of reciprocal trade is the highest in Bulgaria (Table 5.10.).

Table 5.10. **The share of EU–15 and reciprocal trade in trade turnover of countries currently participating in CEFTA in 2003 (in %)**

Country	**Exports**			**Imports**		
	EU–15	**reciprocal**	**total (2+3)**	**EU–15**	**reciprocal**	**total (5+6)**
1	2	3	4	5	6	7
Bulgaria	57.1	3.7	60.8	49.8	2.7	52.5
Croatia	54.6	0.7	55.3	56.3	1.2	57.5
Romania	67.9	2.3	70.2	57.9	1.0	58.9

Source: Own calculations base don Direction of Trade Statistics Quarterly, IMF, Washington, March 2005.

As concerns the total reciprocal exports of the above-mentioned three countries, Romania accounts for the highest volume, as its share amounted to 56.8% of exports, while Bulgaria's was equal to 37.1% and Croatia's, just 6.1%. The distribution of corresponding shares on the import side is more proportional, with Bulgaria accounting for 42.0%, Romania, 32.8% and Croatia, 25.2% of these imports.

An analysis of the flows of reciprocal trade between the current CEFTA countries points to a clear decline in the significance of Croatia (particularly on the import side) in the trade turnover of both Bulgaria, as well as Romania (Table 5.11.). Meanwhile, in the case of Croatia's trade with the remaining two CEFTA countries, Bulgaria is relatively more significant in exports, while Romania, in imports.

Table 5.11. **Geographical structure of reciprocal exports and imports of countries currently participating in CEFTA in 2003 (as %)**

Country	**Exports**			**Imports**		
	Bulgaria	**Croatia**	**Romania**	**Bulgaria**	**Croatia**	**Romania**
Bulgaria	x	15.8	84.2	x	10.4	89.6
Croatia	52.3	X	47.7	24.1	x	75.9
Romania	70.0	30.0	X	91.6	8.4	X

Source: Own calculations based on Direction of Trade Statistics Quarterly, IMF, Washington, March 2005.

Trade exchange has clearly dominated the reciprocal economic cooperation of these three countries. Cooperation in the form of foreign direct investment was practically non–existent, or minimal, according to the available statistics (according to the FDI level as of the end of 2003).

It should also be noted that since May 1st, 2004, trade relations between the EU–8 countries and the current CEFTA countries have been regulated by European Agreements, which the European Union negotiated with Bulgaria and Romania, and the Stability and Association Agreement between the EU and Croatia.

Trade in industrial goods between the EU countries and Bulgaria and Romania is currently taking place without any tariff barriers, while the exchange of agricultural–food products is regulated by reciprocal licences between the EU and each of these countries. Agricultural trade (partly liberalised) is based on the asymmetry principle, working in favour of Bulgaria and Romania. At the end of September 2004, further liberalisation measures were introduced in EU–Bulgaria relations, with regard to access to markets for some processed agricultural products. In the case of Romania, such solutions are still being worked out, according to the same principles as in the case of Bulgaria, i.e. asymmetry in favour of Romania. Talks are also under way regarding the protocols related to EU enlargement. These concern the shifting of the preferences granted by Bulgaria and Romania to countries of the 10, prior to their EU accession. The two countries (particularly Bulgaria) are opting for a solution, which would take into account the shifting of the preferences only in the case of those agricultural goods, actual trade in which between these countries and the 10, has taken place.

Meanwhile, Croatia, as a Western Balkan country, is covered by the Stabilisation and Association Process, which envisages, *inter alia*, a broad range of unilateral EU trade preferences, conditioned upon the fulfilment of certain political and economic criteria. Issues related to the movement of goods between the EU and Croatia have been regulated since March 1st, 2002, by a transitory agreement constituting a part of the Stabilisation and Association Agreement, which went into full effect on February 1st, 2005.

According to this agreement, Croatian goods were granted customs–free access to the EU market, with only minor exceptions.[50] Meanwhile, the abolition of tariff constraints by Croatia is taking place according to schedules set for individual groups of goods. In the case of industrial goods, the liberalisation process is yet to be completed for a group of goods, for which the final stage of the reduction of customs duties will take place on January 1st,

[50] Livestock and beef are excluded from preferential treatment, although veal is covered by tariff contingents. These also apply to some wines, as well as some fish and fishery products.

2007, as well as selected textile and steel products (customs duties to be abolished from 2006). Agricultural goods from the EU have been covered by different schedules of customs duty reductions, but full liberalisation of access to the Croatian market is not envisaged. It is worth noting that trade in industrial goods between the CEFTA countries that joined the EU, and Croatia, have been fully liberalised within CEFTA.

The change in the terms of trade between the five new EU countries that participated in CEFTA prior to their accession, and the current members of this agreement, mainly concerns agricultural goods (with the exception of some industrial goods with longer tariff protection in Croatia's imports from the EU). Considering that EU trade with Bulgaria, Romania and Croatia is (largely) based on the principle of preferences in favour of these countries, while before May 1st, 2004, the relations of these countries with the above–mentioned five countries were based on the principle of equivalence of benefits, the conditions for the access of goods from the countries of the five to the markets of the current CEFTA countries have relatively deteriorated, while those for the access of goods from CEFTA countries to the markets of the five, have improved.

It should also be noted that Bulgaria and Romania are facing a near perspective of joining the European Union, which will result in another change in the terms of trade. Both countries signed the accession treaty on April 25th, 2005, with their date of accession set for the beginning of 2007. However, if they do not meet all their obligations, their EU entry could be delayed by one year. Meanwhile, in the case of Croatia, accession negotiations have not yet commenced. In December 2004, the European Council set their starting date for March 17th, 2005, but the start of the negotiations has been suspended and the setting of a new date is conditional upon the full cooperation of the Croatian authorities with the International Criminal Tribunal for former Yugoslavia.