INTERNATIONAL COOPERATION AND INTEGRATION WITH THE EUROPEAN UNION OF CENTRAL AND CENTRAL-EASTERN EUROPEAN COUNTRIES

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ABSTRACT

This chapter sets out to analyse the international relations of countries in the region of Central and Eastern Europe (CEE). These relations were, in 2006, almost exclusively subordinated to integration with the European Union. Further progress in trade with the EU, facilitated by the inflow of structural and aid funds, was accompanied by rapid increases in bilateral trade in the region. The greatest ever enlargement of the European Union was completed with the accession of Bulgaria and Romania. The candidate countries in the Eastern Balkans have been pushing through the necessary reforms within the scope of their preparations for EU membership. The analysis shows that the prospect of EU membership is a strong stimulus for speeding up the economic and political reform processes. The countries among the group of new EU members that are most advanced in the reform process are now preparing to join the Eurozone. Two clearly distinct groups of countries have emerged in the region, each adhering to different state and economic models, which has translated into the coordinates for regional cooperation: relations with the European Union have become closer, accompanied by a decline in cooperation with individual countries in Central and South-Eastern Europe and the countries of the Commonwealth of Independent States. The growing frequency of outbreaks of tension and conflict in Russia's relations with the neighbouring countries has become a stumbling block to regional cooperation.

5.1. REGIONAL COOPERATION

5.1.1. Introduction

In 2006 the Central-Eastern European countries in transition were becoming increasingly differentiated in terms of their status and position in the world. This resulted in a change of the perception and the map of problems, which preoccupied the societies and the political classes of the respective countries. From the point of view of policy and practical activity of international organisations the area in the focus of our interest is divided into four parts: Central Europe (or Central-Eastern Europe), South-Eastern Europe, Eastern Europe and Russia. This division, applied in official documents, descriptions of procedures, budget documents, aid documents, etc., leads to the progressive institutionalisation and further perpetuation of plausibility of the introduced classification.

Analysing the events in the region of the past year 2006, the overlapping of two mutually opposing tendencies may be observed. On the one hand, we have the progressing globalisation, which presents similar challenges to all the countries, on the other hand it is possible to observe that the policy of any specific country is increasingly becoming determined by its status and structural conditions. It is clearly visible in this regard that the traditional "post-Yalta" division is becoming less and less perceptible or useful for the description of reality.

The Czech Republic, Slovakia, Hungary and Poland are not only becoming increasingly institutionally integrated with the structures of the European Union, but they also increasingly become affected by the processes and participate in the discussions taking place there. In the case of these countries we must therefore take into consideration the general EU trends and problems. A similar view is held of Slovenia, although geographically it is somewhat removed from the areas perceived as "Central Europe". The three Baltic States are also classified in the same group of countries, as they have covered the long way from the status of soviet republics to becoming sovereign member states of the EU and NATO.

For Bulgaria and Romania the year 2006 was marked by the finalisation of the process of preparations for accession to the European Union. Similar subject matter was at the focus of attention, with due consideration for the weight of traditional local ethnic strife there, in Croatia, Serbia, Macedonia, Bosnia and Herzegovina, Albania, Montenegro. In the universe of international diplomacy the habit has been developed – initiated actually by the EU bureaucracy – to treat this whole area jointly under the name of "South-Eastern Europe".

The European states that emerged upon the ruins of the Soviet Union (Ukraine, Belarus, Moldova), even though they differ from one another within this group, they also possess common features, allowing them to be regarded as one region. This perspective is enhanced by the pragmatic approach of the EU, which treats these countries jointly as pertaining to the same part of the "European Neighbourhood Policy". Another chapter of this "Policy" consists of Russia, which stands out distinctly apart. As far as the Asian post-soviet states are concerned, they are increasingly clearly developing into two separate geopolitical areas: the Caucasus and Central Asia.

5.1.2. Weakening of regional cooperation and "integration fatigue"

The present historic moment, in which the countries in transition that formerly belonged to the soviet zone find themselves, constitutes a turning point phase of their changing structural and geopolitical configurations. The traces of intellectual and political thought constructs that prevailed over some 50 years after the end of the second world war are still perceptible, the implementation of plans and concepts developed as results of analyses of their particular realities is still continued. Yet, new assumptions and designs are already beginning to be put to "work" and to play a social role, reflecting the new network of relationships. It is becoming increasingly clear that the geographic shape of the "soviet zone" was an accidental effect of the success of the expansionist policy of the Soviet Union and did not reflect any natural entity. Certain changes, which from the short-term perspective might seem to be disrupting hitherto existing links, in fact lead to the restitution of old configurations, developed over the centuries. This reflection may be summarised by the observation that we witness the birth of new geopolitical arrangement of the part of Europe and Asia that we are interested in, which will result from the recovery (or gaining) of sovereignty and democracy by the countries of the region. This process is currently taking place and perhaps we unable as yet to precisely describe the new situation. As a matter of example, let us point at the sub-region of the "Baltic States". Only in the course of the next few decades we shall be able to see what shape it will really assume. From the historical point of view two elements are indeed in flux:

a) The situation of Finland, which belonged to the region until the second world war, and only after 1944/1945 it followed a different course of development for purely political reasons, so it became more closely attached to the Nordic Scandinavian countries;

b) The situation of Lithuania, where the long-term social, economic and communication factors will determine at some point in time whether this state belongs to the Baltic or to the Central-European region.

The most interesting area for analysis and long-term reflection seems to consist of the states of Central-Eastern Europe, which in political categories are also described as the countries of the Visegrad Group. For over a dozen years these countries were regarded as a successful example of transition of their systems and as an example to be followed by those countries, which embarked upon the course of transformation of their systems somewhat later. Regardless of certain difficulties and local specificity, when assessed from the historical perspective, this region progressed swiftly and effectively on the course of modernisation and adaptation to the structures of the neighbouring European Union, which ultimately all the countries of the region have joined as full members. At a time, when it seemed to be already appropriate to announce and appraise their achievements with admiration, in all of the analysed countries the pro-modernisation and pro-European sentiments perceptibly grinded to a halt (in terms of seeking integration within the structures of the European Union), populist attitudes emerged and old historical resentments came to the surface. In political life, new sentiments were manifested by the polarisation of society to the degree that paralysed the capability to build coalitions in parliament and to create governments. Also, everywhere, anti-liberal attitudes became strong, together with the return to historically tainted politics, often with nationalistic overtones. Such phenomena characterised social and economic life already in the second half of the year 2005, but the practical consequences of the described changes were visible above all in the year 2006.

New political order in Central Europe emerged as the effect of the chronologically first parliamentary elections that took place after the accession of the countries of the region to the European Union. In all these countries it brought about a very deep decline of the positions of the liberal elites, which personified the main stream of anti-communist opposition and which had prepared their countries for EU membership. It is also an interesting phenomenon everywhere that a significant weakening of interest in foreign policy on the part of the new elites is visible (during the early years of transition there was a marked increase of interest in international affairs, including regional cooperation.

In the most recent period, increasingly frequently and loudly, voices and judgements have been formulated in Central Europe claiming the necessity to "complete" the revolutions of the turn of the eighties and nineties. Of course, this presupposes the diagnosis that the first great political change had failed or was betrayed, and in extreme cases that it had even been just ... a hoax.

Generally speaking, these new political phenomena are detrimental for the reputation of the region and of its particular countries. They have also led to a change of the mode, in which the media and analysts looking from outside tend to describe the realities in Central Europe and the phenomenon of political transition. The clearly affirmative convention has been replaced by the convention of balancing the positive and negative aspects.

The phenomenon outlined above is already labelled in literature as "integration fatigue". A rather popular view claims that this is inevitable as a phase of social life, which cannot be avoided, and that other countries following the course of transition must reckon with it and try to wisely minimise its costs. From the point of view of social engineering techniques, sociologists describe and document the phenomenon of the crisis of the culture of compromise in social life. Indeed, in all the countries of the region a growing presence of emotions in political discourse is observed, with the use of aggressive language, the pursuit of covert opponents and their "secret complots". The Polish issue of screening for past involvement with secret security forces [*"lustracja"*] is already being widely depicted in the world as a sociological phenomenon. When describing this problem, amazement predominates in the perception of the changes that have taken place in Poland. Unfortunately, these transformations are mostly assessed negatively and have caused the decline of its prestige, especially in the countries of the "old" European Union.

The efforts of society in the process of modernisation and adaptation to EU standards, however, have generated the side-effects consisting of sentiments and emotions, which then caused the fading of historical differences between the right wing and left wing view of the world. As a result, the circles and the persons having problems with adaptation to new realities have produced a new mix of ideas, where the dividing lines between traditional ideologies are blurred and where populism of leftist origin (slogans concerning "social justice", state control, hand-outs of goods, aversion to market forces) was mixed with right wing and conservative beliefs (the vision of the nation and its traditions, the role of the church and religion, moral conservatism). Classical examples of such new phenomena may be seen in the political rise of such parties as "Law and Justice" in Poland or "Smer" in Slovakia. An interesting situation has developed in Hungary, where the polarisation and the degree of aggression in mutual relations between the government and the opposition is greatest amongst the countries of the region. On the one hand, there is the opposition Fides party, with views close to those of the Polish "Law and Justice", on the other hand, there is the socialist-liberal government, which is the only political force in the entire region of Central Europe that has decided to sign the declaration in defence of the European social model in February 2007. Celebrations of the 50th anniversary of the Hungarian Revolution of 1956 gave rise to open confrontation, which unfortunately took to the streets.

In Central-Eastern Europe the main orientations of foreign policy are also being reviewed and reconsidered. Choices of principles, such as European integration and the Atlantic alliance, are not in question, of course, but rather the shape of regional policy. After over a dozen years of great political transformations, emotions have come to play a lesser role now, the impulse to get away from the existing political situation or the mutual attachment between those who suffered the same oppression is fading. Today, greater significance is again attributed to traditional bonds and historically defined national interest. A good example may be provided by the analysis of discrepancies between the details of political concepts in Poland and Hungary. On the one hand, Hungary is devoting increasing attention and more engagement to the countries of its traditional sphere of interests, that is to Croatia and Romania, and to a lesser degree to Slovenia and Serbia. On the other hand, Poland devotes much effort and time to relations with Lithuania and Ukraine – as its traditional areas of interest. It is not surprising, therefore, that several times during talks and consultations in the course of the year 2006 both parties noted the wide divergence of the fields of their interests. If we add to this a certain degree of tension in the analysed period in Hungarian-Slovak relations, from which Poland wants to keep at a maximum distance, it becomes clear that it would be an exaggeration to talk about any community of foreign policy here.

As far as the immediate southern neighbours of Poland are concerned, in 2006 there was a visible ideological rapprochement between the presidents of the Czech Republic and Poland, although it did not give rise to any perceptible intensification of relations between these states. Unfortunately, this ideological closeness between these presidents was noted by the international press and by analysts as common ground built on the basis of Euro-scepticism and a negative attitude toward the project of the European Constitution.

The idea of cooperation between the countries of Central Europe, which in some form is natural and is present since the late middle ages, gained new strength and popularity in the second half of the nineteen-eighties. This was inspired by opposition and dissident circles, in defiance of the official authorities, which were theoretically conducting a policy of cooperation and intensive integration in the COMECON framework, but in fact, for political reasons, tried to isolate their respective societies from each other.

The Visegrad Group

Currently, on the territory of Central and South-Eastern Europe, which is the area of countries in transitions that are in the field of our interest, several ideas of regional cooperation are in circulation. Apart from the "Visegrad Group", which functions since over a dozen years with mediocre success, meetings of state leaders referring to the concept of the Central European Initiative continue to take place all the time, and since 2001 the "Regional Partnership" project is carried on, following the inspiration given by Austria and embracing the Visegrad countries together with Austria and Slovenia. We may observe today some sort of balancing between two initiatives: the "Regional Partnership" and the "Visegrad Group". The Visegrad cooperation has longer tradition and is stronger rooted in the practice of international cooperation of various ministries and public institutions. The "Regional Partnership" develops more dynamically, perhaps, as the effect of the significant organisational effort contributed to this concept by Austria, for which that idea represents a chance to play a greater role in the region. Today, both concepts coexist next to one another. In longer time perspective they will probably either merge, or one will be absorbed by the other. This implies that the institutional crystallisation of a block of Central European states is still ahead of us. It could embrace not only Austria and Slovenia (Slovenia is traditionally strongly supported by the Czech Republic), but also the states supported by Hungary (Croatia, Romania), as well as those favoured by Poland: (Lithuania and Ukraine)[1].

Eastern Balkans

The year 2006 was particularly important for Romania and Bulgaria, which were intensively finishing their preparations for EU accession, and finally became its members from 1 January 2007. The last leg of the negotiations was conducted already in a new atmosphere, which was determined by the sceptical discussion recapitulating the decision on the EU enlargement embracing Central Europe and by the awareness of the lost referendum in France and the Netherlands concerning popular approval of the Constitutional Treaty project. In the atmosphere of scepticism and certain suspicion concerning the EU adaptation capacity of the Eastern part of Europe the negotiations were conducted without the empathic component, which was still present several years earlier. On the other hand, however, the decision was made to accept the accession of both countries (and to end in this way the "fifth wave of enlargement") without fully observing the implementation of adaptation procedures (that is without closing all the negotiation chapters).

By admitting Bulgaria and Romania, and receiving them in this specific way, the Union wanted to symbolically demonstrate that it had reached the limits of its capabilities within the existing structures and presumptions. The last accession is to be the crowning of a certain process. Now thorough reflection and reconstruction of the Union must take place. This is required both by the order of magnitude of the organism of the EU, which is completely different after the five enlargements from what was in place at the time of its creation, as well as the necessity to increase the efficiency of the European economy, in order to assure its competitiveness in the 21st century. The great and fundamental discussion on the model of civilisation is also not without importance: what serves the benefit of man and society better: the "social model" or the "free market"?

In the autumn of 2005 the Union opened the accession negotiations with Croatia and Turkey, and recognised the Former Yugoslav Republic Macedonia as a candidate country. The Union also confirmed its readiness to consider the possible membership of other states of the Western Balkans, under the condition that they would fulfil the accession criteria (Albania, Bosnia and Herzegovina, Montenegro and Serbia (together with Kosovo; subject to the condition of fulfilment of the Resolution 1244 of the UN Security Council). The case of Serbia is of a special kind, as the European Union turned to it with the question as to its choice of strategic orientation and the courage to opt for the European orientation. Many analysts are afraid that Serbia might take the path of nationalistic historical policy. In any case, in the nearest future the events in Serbia and Kosovo will be attracting the attention of international public opinion and the political weight of such EU programmes as, for example, the *South East Europe Cooperation Procedure* will increase significantly.

Documents of the European Commission also mention the possible membership of Turkey, indicating that it is rather a distant prospect. From the Polish point of view it is significant that, essentially, Ukraine is omitted in the deliberations on the further enlargement of the Union. Poland is rather isolated as a consistent advocate of the idea of Ukraine's membership of the Union[2].

European Neighbourhood Policy

An additional factor differentiating the post-Soviet transition countries consists of the emergence of the *European Neighbourhood Policy* (ENP) of the European Union, which reinforces the division between those states, which are already in the Union, and those that the object of external policy. The Idea of the ENP is a relatively new concept in the politics of the Community, as a derivative of the decision to put off in time any further enlargements and as a sort of substitute replacing them. This idea emerged only in 2003 and the name itself appeared first in a document from May 2004. This concept is still at the

[1] The case of Ukraine is special, as it is a great country by the standards of this region, but also the only state on the above list of countries, which is not a member of the European Union and has very distant prospects for EU membership, which is a significant barrier to any institutional concepts.

[2] It is worth stressing that consensus prevails amongst the Polish elites concerning the support for the European aspirations of Ukraine. This is a significant accomplishment of Polish political thought.

stage of being developed. The first serious "Proposals" were disseminated only as late as December 2006. In the preliminary plans at the end of 2006 it was assumed that the German Presidency in the first half of 2007 would prepare its precise assumptions, but this task has not been realised yet and is slipping away over time.

The European Neighbourhood Policy concerns 15 countries, including 5 countries of the region of interest to us: three Caucasian states, Ukraine, Belarus and Moldova. A special programme, linked with the "Neighbourhood Policy" (but nevertheless separate from it) consists of the "Strategic Partnership" determining the framework for cooperation with Russia.

In December 2006 the new idea of expanding the zone of cooperation of the European Union was formulated, which is extremely interesting in the context of the post-soviet area in transition. The objective of this project, called the *Black Sea Synergy Programme*, is to activate the cooperation and to develop the appropriate infrastructure of links between new members of the Union – Bulgaria and Romania, and the states interested in European cooperation – Ukraine, Moldova, Turkey, Georgia, Azerbaijan and Armenia. In the next few years the above programme may become an important factor in the process of transformation and modernisation of the region. On 11 April 2007 the European Commission has prepared the first information for the European Council and the European Parliament concerning the assumptions of this programme. The concept is still in the process of crystallisation and is open to changes, amendments and new ideas, including those coming from the new member states. The *Black Sea Synergy Programme* may become an important element of pre-accession strategy both for Turkey and for the countries of the Caucasus region.

In terms of the global assessment of the situation in the post-soviet area and the political and economic transition taking place on its territory, in turn, the evaluation of the situation in the Ukraine is of key significance – both owing to its size and potential, as well as the strategic location of that state. A rather widespread opinion prevails that the transformation of Ukraine has been significantly slowed down. The forthcoming months, or possibly even years, must be devoted by the Ukrainian state to making up for the losses caused by the internal political crisis.

Trans-Caucasus

Among the post-soviet area countries in the region of the Caucasus, Georgia's move toward closer relations with the Euro-Atlantic structures, which are already largely accomplished, is of particular significance. In April of last year, all the members of NATO at the meeting of its Council in Brussels have expressed their support for the idea of admitting Georgia to the ranks of that organisation. On 21 September 2006, NATO adopted the decision to launch the "Intensive dialogue concerning the membership aspirations" of Georgia. This was a significant decision, as it raised the level of contacts one step higher in comparison to the preceding "partnership".

In this context the active stance of Poland with respect to the countries of the Caucasus Region should be noted, especially in relation to Georgia. Over the first 17 months of the term of office of Mr Lech Kaczyński as President of Poland there have been 8 meetings with the President of Georgia, Mr Mikhail Saakashvili, including five visits by President Saakashvili to Poland and one official visit of the President of Poland to Georgia. Georgia was also visited by the Polish Speaker of Parliament (Marshal of the Sejm) and by the Speaker of the Senate. It is therefore appropriate to say that the relations between the two states are particularly intensive. This impression is also confirmed by the declarations made by both presidents, as well as the relations of cooperation established in the field of defence.

5.1.3. Energy Supply Cooperation between the States in the Region

The year 2006 has fully demonstrated the acuteness of the issue of supplies of energy resources in international politics. The Ukrainian-Russian argument concerning the supplies of gas started already in March 2005, when Russia demanded from Ukraine much higher prices for gas and new rules for settling the charges for the transit of gas across Ukrainian territory to Western and Central Europe. The new prices were much higher than before and strongly struck the Ukrainian economy, which was very gas-intensive and accustomed to the low price of gas. It is true that the proposed prices were still below the global market price level, although it is also true, that under the conditions of post-soviet economy the market realities still play a lesser role than in other parts of the world, and that the changes proposed by Russia would have had the impact of a shock.

Ukraine is the fourth importer of gas in the world in volume terms, but at the same time it is its sixth exporter. Over the last few years Ukraine has been using up approximately 80 billion cubic metres of gas, 20 billion of which came from its own production and 36 billion was bought from Turkmenistan. The remaining gas came from Russia, although approximately 6 billion cubic metres were actually purchased, whereas much more, some 17 billion cubic metres were taken by Ukraine as payment in kind for the transit of gas from Russia to the West. The Russian side, seeking to gain sympathy of worldwide public opinion for its own policy, attempted to disseminate information about "the unjustified and unearned" revenues of the Ukrainian side from the transport of its gas. For example, it claimed that Ukraine was selling gas to Romania for the price of USD 260 per 1,000 cubic metres, while it pays for the same gas only USD 50.[3]

Because before the new year 2006 a new pricing agreement could still not be reached, Russia decided to stop the supplies to Ukraine from 1 January 2006, sending only the amounts contracted by customers from the European Union. As Ukraine regarded the rules hitherto governing such transit as being still in force, it continued to draw the required amount of gas from the pipeline, reducing in this way the amounts delivered to its western border. The shortages of supplies began to be felt and to cause problems in the neighbouring countries already after several hours, and somewhat later also in Western Europe. After four days the parties arrived at an agreement and supplies in normal, previously contracted volumes, were resumed.

The crisis concerning these supplies was short-lived, but its political and psychological effects were huge and long lasting. The western European sense of security broke down and the conviction that Russia, no matter how critically it may be viewed, was a stable and reliable trading partner was undermined. For western and worldwide public opinion it became clear that Russia was ready to use the supplies of energy resources as an instrument of foreign policy. This really caused fear and concern. Over a few days, a significant re-evaluation of the relationship to Russia occurred. At the same time, the policy of energy security became one of the most important topics (and slogans) in global politics.

Over the fifty years that have passed since the establishment of the European Union, the member states did not regard energy policy as a priority. Over the last few years the situation has changed and today energy security is treated with equal seriousness as terrorism and the proliferation of weapons of mass destruction. The European Union depends on the supplies of oil and gas from three countries not belonging to the Union: from Russia, Algeria and Norway. Moreover, owing to the already occurring decline of Norwegian reserves, the dependence on Russia will increase even further. An additional cause for concern consists of the fact that the Russian corporation Gazprom, which is the owner of reserves and manages the whole pipeline transport system on Russian territory, does not allow foreign firms to have access to its networks, in spite of increasingly strong protests.

The EU countries ignored the aggravation of this problem for a fairly long time. This was so, because the quest to develop a common energy policy remained in conflict with the interests of many states, which did not want to give up their national control over such a vital domain of the economy. Individually, particular states attempted to defend their interests by means of bilateral talks with Russia, sometimes also at the expense of other EU countries. Russia took advantage of this situation, trying to apply the "divide and rule" approach. Only the publication on 8 March 2006 by the European Commission of a special Green Paper on energy security opened the way to serious debate on this subject.[4]

A remarkable and optimistic new factor consists of the recognition by the NATO summit in Riga, deliberating at the end of 2006, of the issue of energy security as an important element of defence policy of the countries belonging to the Alliance and the appearance in political discourse of the analyses of the notion of aggression in the form of undermining the energy supply stability of any member state. A new chapter in reflection and planning was opened, which most probably in the near future will bear fruit in the shape of formal recognition of an "attack against energy security" as fulfilling the premises of Article 5 of the Treaty establishing NATO.

About 1/3 of the consumption of oil in the European Union and as much as 40% of gas is provided for by supplies from Russia. Of course, the situation varies from country to country. Generally speaking, the dependence of Central Europe is much greater.[5] On the other hand, however, proceeds from the sales of energy resources to the European Union constitute over 40% of the budget revenues of Russia. These indicators allow for some optimism concerning the feasibility of compromise being reached by both parties. In October 2000, the EU and Russia have agreed to start negotiations in the context of "Energy Dialogue".

Since the middle of the nineteen-nineties, Russia has been planning to become actively and directly involved in

[3] In December 2005, specially to deal with the issues of gas, the prime minister of Ukraine at that time, Yuriy Yekhanurov, went to Moscow. The negotiations ended without reaching an agreement. After the return to Kiev, in a statement broadcast on 26 December 2005 on Channel 1 of the national television, Yekhanurov declared that Ukraine would continue taking over 15% of the Russian gas for its own needs as a fair transit charge.

[4] The Green Paper sets out the orientation of the works leading towards the establishment of a "common energy market", based on the principle of solidarity. It is planned to establish a special European "Energy Observatory" and the institution of the "Energy Regulator", which will prepare, as soon as possible, the strategic action plan until the year 2020, taking into account the factor of global warming. On 6 September the European Commission has published, for the first time, "Guidelines" concerning the development of the Trans-European Energy Network (TEEN or TEN-E are the respective English abbreviations in use).

[5] These problems were discussed at length in last year's Report (see: "New Europe. Report on Transition 2006", Instytut Wschodni, Warsaw, 2006, Chapter 7).

the business of supply of energy sources to Western Europe. With this objective in sight concepts for several new strategic pipelines have been developed: the Northern Pipeline, which would bring gas from the region of St. Petersburg to north-eastern Germany, by-passing such countries as Lithuania, Belarus and Poland. The Russian-German joint undertaking was planned in the final period of the term of office of the German Chancellor Gerhard Schroeder - in a way, which according to Poland and Lithuania would enable to individually stop the supplies just to those countries.[6]

Poland and the countries of the Baltic Sea (especially Sweden) are raising the problems concerning threats to the natural environment, which might arise when laying the pipelines on the bottom of the Baltic, given the situation that after the second world war huge amounts of ammunition and chemical weapons were deposited there, including war gases. Disturbance of these deposits might cause a gigantic ecological disaster in Northern Europe.

Since a number of years work has also been in progress on the concept of an oil pipeline from the Bulgarian port of Burgas on the Black Sea to the Greek port Alexandroupolis on the Mediterranean coast on Greek territory. This 280-kilometers long pipeline is intended to eliminate the necessity for supplies to be shipped across the Turkish straits. Its construction is supposed to start already in 2008, and according to the plan it is to cost 709 million Euro. And, of course, it will lead to a further increase of dependence of the EU on Russia for energy supplies (see: Chapter II).

The strategic response to Russian plans consists of the concept of intensifying the transportation of energy source materials by the so called southern route, from Kazakhstan and the Caspian-Baku oil fields over Georgia, Turkey and the Black Sea. This concept has a few alternative variations. The different countries concerned are trying to modify it in accordance with their own interests.

The most tangible project carried out so far has consisted of the construction of the oil pipeline Baku-Tbilisi-Ceyhan, where mostly British and Azerbaijani capital was engaged. This 1,776 kilometres long pipeline was laid in just 3 years. The first stream of oil across its whole length was carried in May 2005, and exactly one year later its normal regular exploitation began. The pipeline creates convenient conditions, because it delivers gas directly to the port on the Mediterranean Sea (so it is no longer necessary to cross the Turkish straits navigating with tankers) and it has over 13 times greater throughput (1.5 million barrels per day) than, e.g. the pipeline from Baku to Supsa on the Georgian coast of the Black Sea.

In resolving the issue of gas supplies, a key role is to be played by the gas pipeline "Nabucco", the construction of which is to start in 2008 and is to end after three years in 2011. This long pipeline, spanning a distance of 3,300 kilometres, is to lead from Turkey across Bulgaria/Greece/Romania to Austria and Italy (two separate lines) and in this way to supply the whole of Europe. The gas pipeline is to be correlated with the planned or existing networks delivering gas to Turkey from Azerbaijan, Iran and Iraq. The programme is to be fully completed by the year 2020. The project, in progress since 2004, is financed (and will be owned) by 5 partners from Austria, Turkey, Hungary, Romania and Bulgaria. Thereby, the interests in this particular supply line are determined in the foreign policy of the specific countries involved. The project arouses the concern of the Russian Gazprom, which is making efforts to carry out the competing "Blue Stream" project, leading from the eastern part of the Black Sea to Turkey, and subsequently over Bulgaria, Serbia and Croatia to western Hungary, where it would be connected to the European networks.

In both cases the northern part of Central Europe (e.g. Poland or Lithuania) remain left out from the network of these connections. Both projects also leave aside the Ukraine. In this context one should look at the activities of Poland, Ukraine and Lithuania, which in the spring of 2007 undertook an attempt to agree on a new supply line project – concerning oil coming from potential reserves in Kazakhstan, Azerbaijan (and possibly Turkmenistan), over Georgia to the western part of the Red Sea (terminal in Odessa on the Ukrainian coast), and still further to Poland, reaching the Baltic coast and the Polish oil terminal and the oil reloading port in Gdansk. The project relies on the already existing fragments: Odessa-Brody in the Ukraine and Płock-Gdańsk, which are parts of old systems originating still from the Soviet era and the "Druhzba" complex.[7]

[6] Chancellor Schroeder was subsequently employed – against all ethical and legal norms – by the contractor managing this project, namely the Russian-German firm registered in Switzerland and formed specially for the purpose of this venture under the name "Nord Stream". This decision was received by general criticism on the part of public opinion, as an example of conflict of interests and violation of ethical standards in business. Former chancellor Schroeder is still politically active as a lobbyist for the Northern Gas Pipeline. In February 2007 he paid a formal promotional visit to Brussels, where he met with the Commissioner for Industry, Gunter Verheugen, and the Commissioner for Energy, Andris Piebalgs.

[7] The April visit of the President of Poland, Mr Lech Kaczyński, to Kazakhstan, which had the objective to gain over the head of that state for the idea of participation in an energy transmission project independent of Russia, did not bring the expected results. President Nazarbayev publicly announced that the condition for the involvement of his country in any new pipeline construction projects consisted of the participation of Russia (sic!), which seemed to be a sort of negative response. Poland did not take this as a discouragement and a month later, in collaboration with Lithuania, it organised an "Energy Summit" of the interested states in Cracow.

5.1.4. Conflicts with Russia

Recently, regional cooperation is becoming increasingly overshadowed by unresolved political and trade disputes with Russia. In 2005 Russia introduced an embargo against the imports of meat from Poland, motivated by irregularities in the issuing of veterinary certificates and supposedly low quality of Polish meat. In 2006, in turn, after the decision of Lithuanian authorities to sell the Mazeikiu Nafta oil refinery to the Polish corporation PKN Orlen, the Russian firm Rosneft suspended the supplies of crude oil to that refinery, justifying this by the necessity to repair the oil pipeline. These two cases are just the most publicised examples of conflicts over trade issues between Russia and Central-Eastern European countries. They overlapped with events of a purely political nature, such as the crisis in Russian-Estonian relations in connection with the decision to displace the monument to soviet soldiers in Tallinn.

Demanding support from the European Union in the dispute with Russia, in November 2006, Poland decided to block the adoption of the negotiating mandate for the European Commission concerning the new framework agreement between the Union and Russia. This drastic move, although it was initially criticised, did accomplish its purpose of making the European public opinion more sensitive to and aware of the threatening aspects of Russian policy with its neo-imperial ambitions. The Union and its particular member states decided to adopt a more assertive stance with respect to Russia, as demonstrated by the course of events at the EU-Russia summit in Samara in May 2007.

The issue of Polish meat was a significant factor contributing to a change in the perception of Russia prevailing in Western Europe. Russia's strategic goals began to be recognised there, such as the subjection of Europe to its dominance through the gaining of control over energy distribution networks. Events having a negative bearing upon the perception of Russia in the world began to multiply: the murder of the journalist Anna Politkovskaya in Moscow and of the former KGB agent Litvinenko in London, the meeting of President Putin with former Stasi functionaries during his visit to Germany, or the aggressively cold war like speech of the President of Russia in Munich, at the annual Conference on Security in February 2007. By the middle of 2007 the relations of Russia with the European Union and the USA reached a phase of being virtually frozen, although one cannot speak of any open crisis in this regard.

President Nazarbayev did not take part in its deliberations, but only delegated his representative at the rather low rank of deputy minister. The results of this summit are ambiguous, nevertheless they do not imply an end of this initiative. The meeting of the same group, which is to be held in September in Vilnius will be of decisive significance.

5.1.5. Conclusions

The post-soviet countries and economies in transition, as a consequence of a process, which is in progress since 18 years already, are gradually becoming increasingly differentiated, becoming divided into several regions, each with its own specificity. It should be expected that these processes will be even more pronounced in the nearest future. The key factor for the forthcoming situation of the European countries in transition will consist of the mode of progress and the geographic scope of European integration. It is significant, with what force will the syndrome of "integration fatigue" be manifested, what consequences this will have for the political situation in the region and for the perception of that situation from the outside (on the part of partners from the "old" Union). The sense of a common identity based on the shared legacy of a communist past will increasingly weaken; a progressively greater role will be played by traditional links and interest orientations of particular countries.

As a matter of the next few years, one of the most important issues determining the political climate in the region and providing the focal point for discussions on the economy and the interface between the economy and politics will consist of the problems of security of energy supply.

An important factor shaping the geopolitical situation in the region consists of the position of Russia and Russian politics. It gives rise to growing concerns caused by the growth of authoritarian tendencies in internal politics and neo-imperial aspirations in foreign policy. The place of Russia is determined, above all, by global factors (USA, NATO, China), and by the role of traditional energy resources.

5.2. CHANGES IN FOREIGN TRADE OF NEW MEMBER STATES[8]

Immediately after accession to the EU on 1 May 2004, in most new member states (NMS) the rate of growth of foreign trade accelerated in comparison to the year 2003; with the exception of exports in Slovakia and Malta. The high growth rate of foreign trade persisted also in the year 2006. Only Cyprus noted a drastic slow down of the growth rates of both exports and imports (exports to the EU-25 declined also in absolute terms) – Chart 5.1. The average annual growth rate of foreign trade of NMS countries over the years 2004-2006 amounted to 20.0% in exports and 17.6% in imports. In that period mutual trade between NMS counties grew fastest – on average at the

[8] Statistical data and graphs were prepared by Łukasz Ambroziak.

pace of 29.2%. Also the exports from NMS to countries outside the EU grew swiftly – the rate of growth reached 26.6% in that period (imports grew by only 12.4%). Exports to the EU-15 grew slower – over the years 2004-2006 their growth rate averaged 16.0% per year (imports grew over the same period by 18.3%).

The dynamic growth of turnover of new EU members in the last few years was driven by a number of factors. In part, it reflected the improvement of the global business cycle trend and the attached growth of demand on the largest markets of the world: USA, Germany, China, Japan. Global trade grew by 22% in the year 2004 over the previous year and by 15% in 2005.

Undoubtedly, a significant role was also played by the accession to the EU. It was not so much the very fact of accession to the Union from the 1st of May 2004, as most barriers to trade, including customs duties, had been removed earlier. The factor of key significance, however, was the prospect of membership as a force enhancing the modernisation of the economies of the countries of Central-Eastern Europe. Already a number of years before the EU accession, the business enterprises of the then candidate countries undertook steps towards their restructuring and modernisation, which resulted in the improvement of their competitive capacity and laid the foundations for relatively smooth adaptation to the competition prevailing on the single European internal market. The new member states also had to adopt the very extensive *acquis communautaire*, including regulations concerning technical, fiscal and legal-institutional harmonisation, which required a major legislative effort, but at the same time it enabled their firms to join the free flow of goods in the framework of the enlarged EU rather effectively. In other words, the preparations to EU membership, which were undertaken already in the nineteen-nineties, were of key significance for the improvement of competitiveness of the new member states and for their achievement of a positive net balance of EU accession.

The overall dynamics of NMS trade turnover were decisively determined by the trends in turnover with the EU-25, which dominates in the trade of these countries. In 2006 the fastest growth rate of exports to the other EU member states took place in Slovakia – 29%. In Poland, the Czech Republic and Slovenia such growth slightly exceeded 20%. Cyprus was a country that noted a relatively large absolute decline of exports to the other EU countries – by 16%, combined with the stagnation of exports to countries outside the EU-25 (partly this consisted of a statistical effect, after very strong export growth in two preceding years). In all the other new member states exports to the EU-25 increased, although, as a rule, at a weaker pace than in the first two years after accession.

Exports to countries outside the EU-25 increased most strongly in Estonia, attaining a record rate of almost 90% and it was the third consecutive year of such strong geographic reorientation of the exports of that country (mainly in favour of such countries as Russia, USA and China).[9] In the remaining countries (with the exception of Cyprus, which, as already noted, suffered a deep break down of exports in 2006) exports beyond the territory of the European Union significantly increased: between 20% and slightly above 30%.

Trends of changes in imports of NMS countries were different. As far as imports from the EU-25 are concerned, the fastest growth was noted by Latvia and Lithuania – at the level of approximately 30%. Imports to Malta registered a slight decline (by 1%, but accompanied by over 40% increase of imports from countries outside the EU). Imports to Cyprus grew by 5%, and in the remaining countries by about 13-20%. Imports from areas outside the EU-25, however, generally grew more than from the EU-25, with the exception of Lithuania and Latvia. In Slovakia, Malta and Estonia the increase reached as much as some 40%.

These trends suggest that in most countries the phenomenon of faster growth of imports from areas outside the EU than from the EU, which was visible already in the previous year, indicating a certain shift of demand for imports favouring non-EU suppliers, was sustained.

If the whole period from the moment of accession in 2004 to the end of 2006 is taken into consideration, the most important trends in foreign trade may be described as follows:

- In all of the analysed countries the growth of exports was faster, on average, than in 2003 (to non-EU areas), with the exception of Slovakia and Lithuania (where the opposite was true);
- The greatest acceleration of the dynamics of exports on a year to year basis took place in Estonia (from about 5% to as much as 89% in 2006!);
- Exports to the EU-25 in 2004-2006 also grew much faster than in the pre-accession period (with the exception of Slovakia, although the sales dynamics in that country in the period under discussion were just slightly weaker than in 2003); the situation in exports improved also in Malta, after the absolute decline in 2003 and 2005; Cyprus is a distinct case, where after booming growth of exports to the EU-25 in 2004-2005 and somewhat slower to other countries, in 2006 this dynamic upsurge broke down;

[9] The growth of these exports was mainly driven by the significant increase of exportation of bituminous substances (of which Estonia has rather large reserves) and processed products on their base, as well as machinery and electrical engineering products.

Chart 5.1. Rate of change in foreign trade of new EU member states in relations with the EU-25 and with third countries, 2003-2006 (previous year =100%)

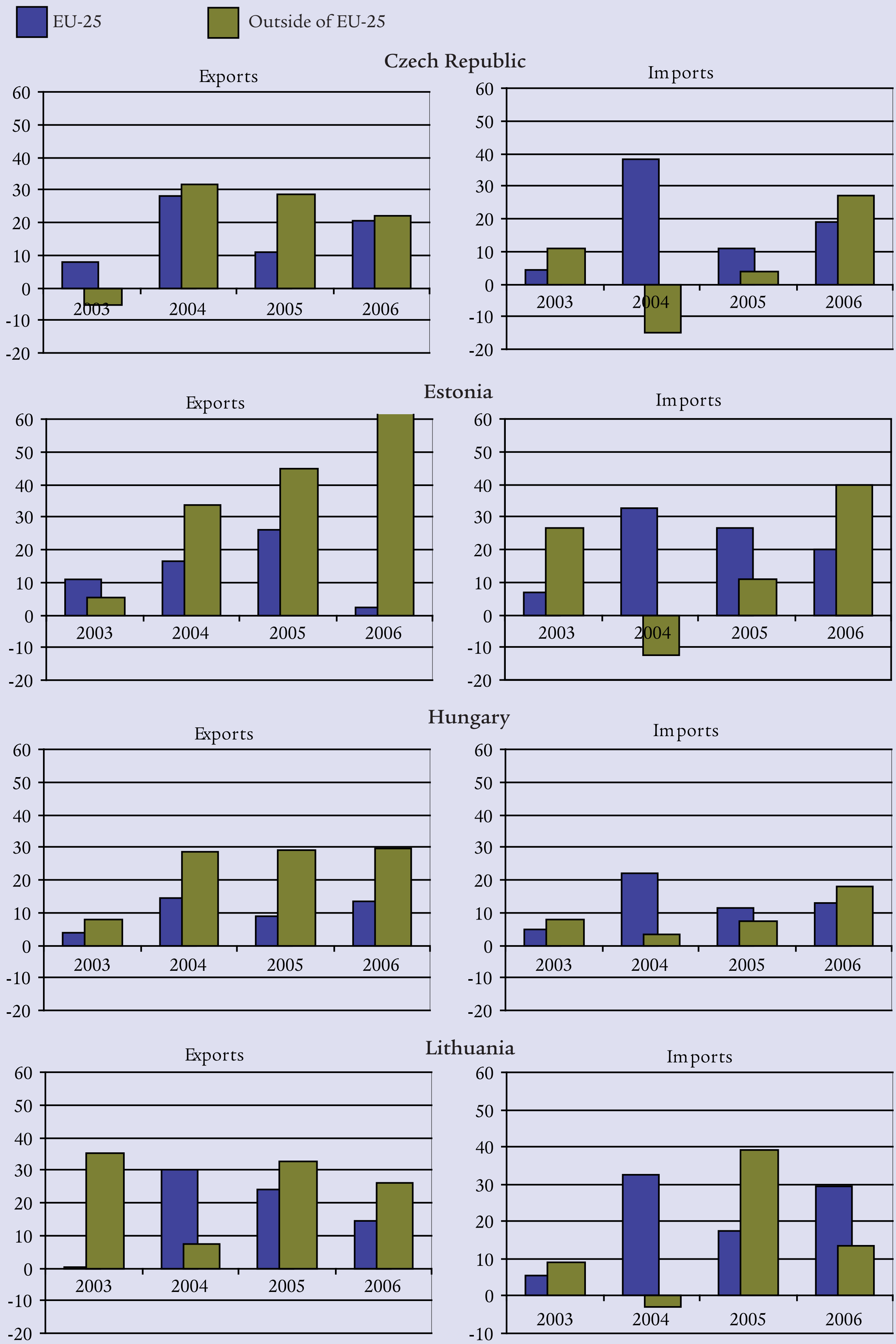
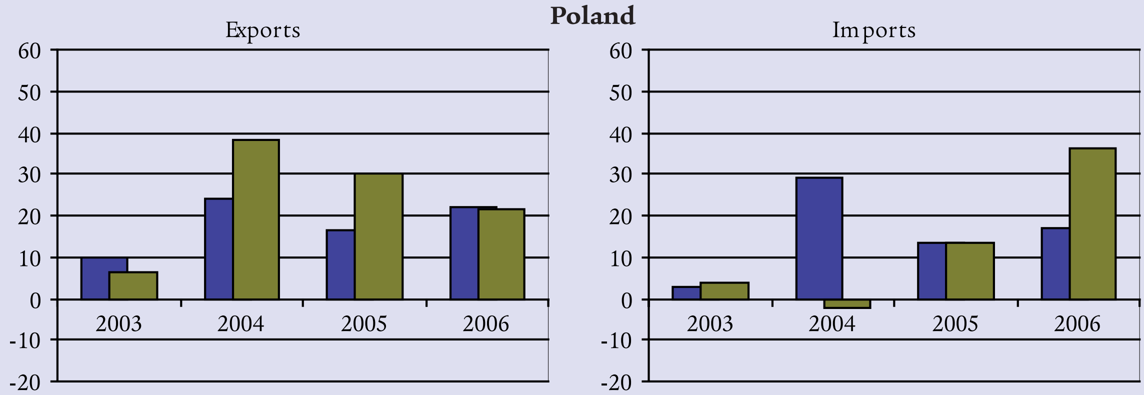


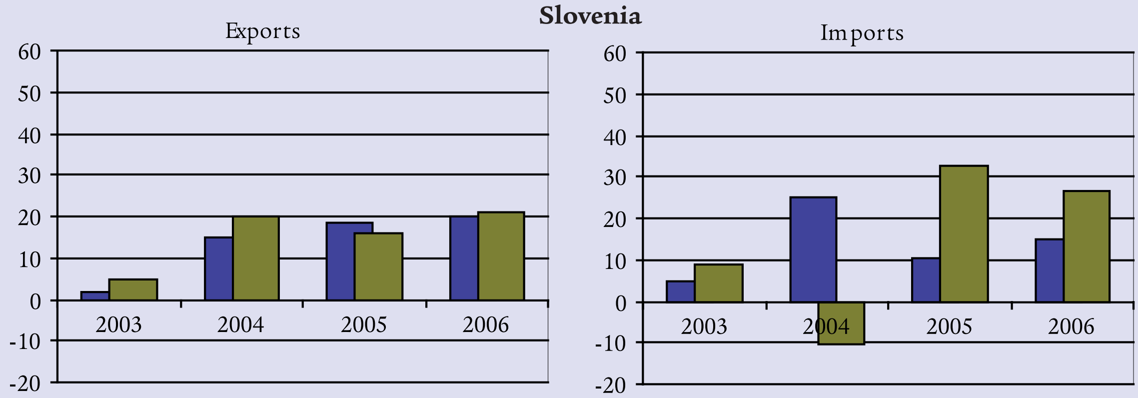
Chart 5.1. (cont.)

Latvia

Poland



Slovenia



Slovakia

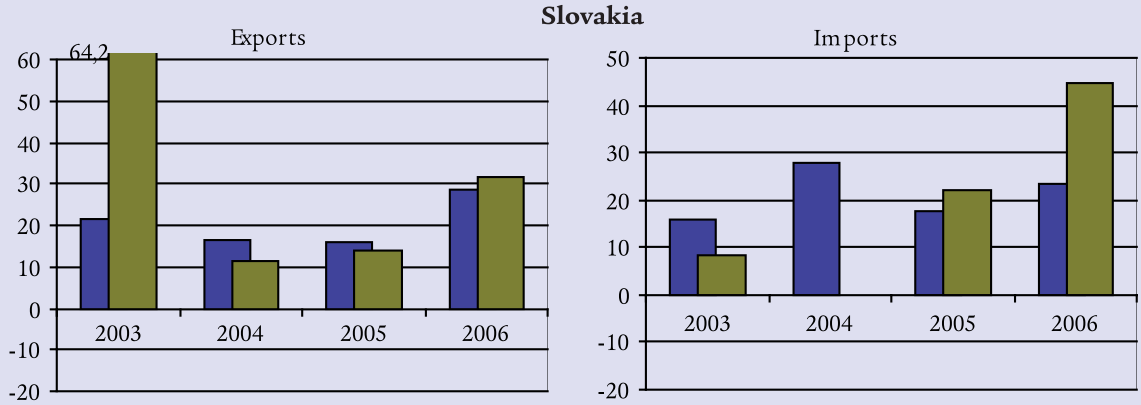
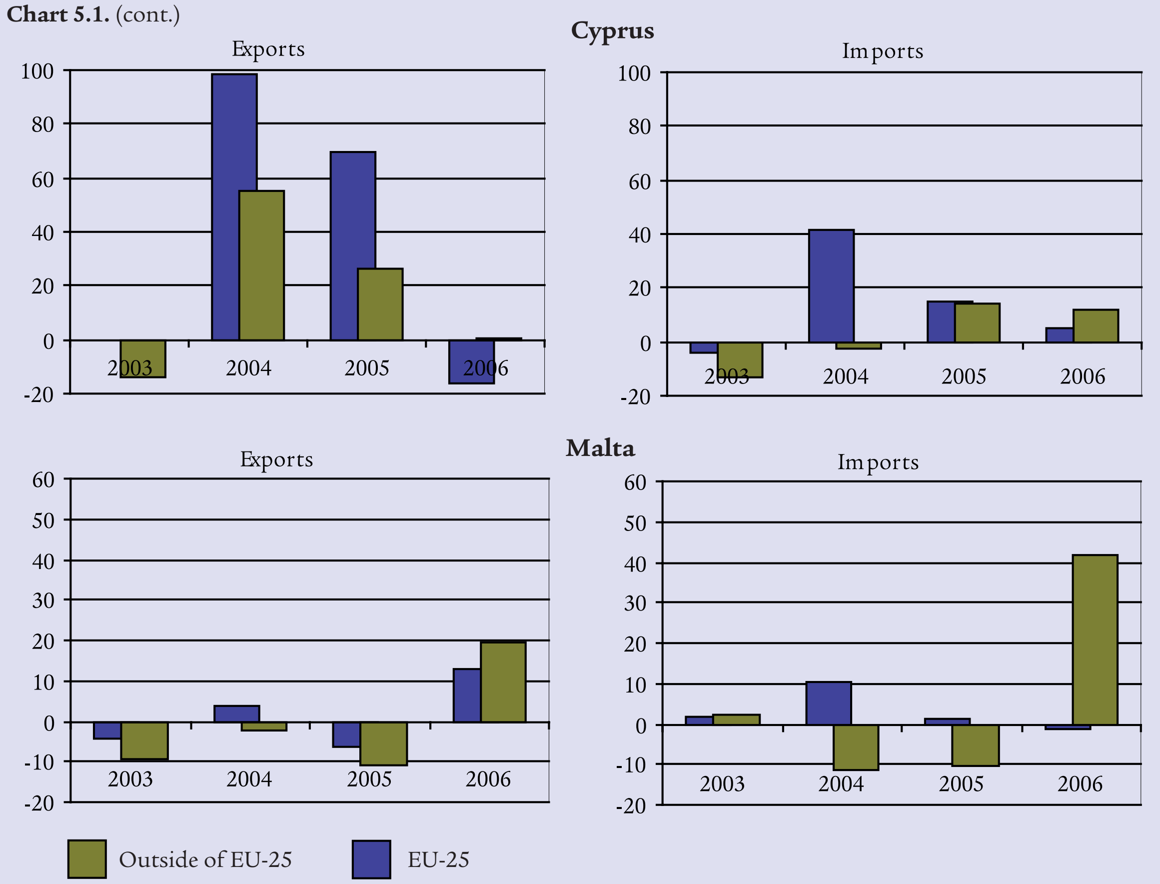


Chart 5.1. (cont.)



Source: Prepared by the Author based on statistical data from: EUROSTAT-Comext.

- After the sudden acceleration of imports from the EU-25 in 2004, in subsequent years in most new member states we observe the slow down of this growth rate; this phenomenon has been weakest in Latvia;
- Trends of change in imports from outside of the EU-25 were completely different: in all of the new member states, with the exception of Latvia, in the first year following the accession a decline (absolute or relative) of imports from the area outside of the EU-25 was noted, reflecting the typical shift of trade in favour of partners from the preferential group. However, in the two years that followed (2005-2006) this trend was reversed and from year to year we observe the acceleration of the rate of growth of imports from countries outside of the EU-25. At the same time, in 2006, the growth of imports from outside of the EU-25 was much higher in some countries than one year earlier. In other words, the phenomenon of the shift of trade from the areas remaining outside of the EU in favour of partners within the Union was very short-lived in almost all of the analysed cases. Any explanation of this tendency would require more detailed analysis, undoubtedly one of its causes consisted of the growth of prices of raw materials, which was visible in the last few years, especially of energy resources, imported to the EU-10 from the area outside of the EU. A second cause consists of the reduction of average rates of customs protection and the liberalisation of imports in most NMS after joining the EU and adopting a common customs tariff. Finally, a significant role is played since a number of years by the sharp competition from China, which persists since a number of years. It keeps embracing ever newer and more advanced product categories, which thanks to their high price competitiveness and fairly good quality keep attracting new clients in the EU. It should be added that from the beginning of 2005 the quantitative barriers to imports of textiles and clothing from China were removed (and from other countries – based on the agreement from the Uruguay Round). The resulting effect consisted of over 40% growth of textiles and clothing imports to the whole EU-25 in 2005.

The general acceleration of imports was also driven by the higher rate of economic growth than previously in the new member states of the Union, significantly exceeding the growth rate prevailing in the EU-15.

5.3. PREPARATIONS OF THE NEW EU MEMBER STATES FOR EUROZONE ENTRY[10]

All the new member states of the EU belong, at the same time, to the Economic and Monetary Union (EMU). All of them have also agreed in their accession treaties to join the Eurozone in the future, after having fulfilled the required criteria. Given that at the time of EU accession they did not fulfil these criteria, they obtained the so called status of EMU participant countries with a derogation. The obligation to adopt the common currency implies, above all, that these countries should apply disciplined macro-economic policy, which enables both their sustainable development and brings them forward towards meeting the convergence criteria (so called Maastricht criteria). Such policy is intended to assure the maintenance of low public finance deficit, low inflation and a stable exchange rate.

Box 5.1. Nominal convergence criteria:

- Inflation measured by the consumer prices index should not exceed the so called reference level, that is the average inflation in three EU countries with the best price stability indices, increased by 1.5 percentage points.
- Budget deficit not exceeding 3% GDP.
- Public debt not greater than 60% GDP.
- Long-term interest rates should not exceed the so called reference level, that is the average long-term interest rate in three EU countries with the best price stability indices, increased by 2 percentage points.
- Maintenance of normal range of foreign exchange rate variations within the Exchange Rate Mechanism - ERM II - over at least 2 years.

Countries aspiring to the Eurozone must regularly present convergence programmes[11], serving for the assessment of the implementation of their policy of approaching the Eurozone. At the same time, these countries are subject to periodical reviews conducted by the European Commission and the European Central Bank from the point of view of fulfilment of the nominal convergence criteria and the degree of alignment of national legislation with respect to the Central Bank and European requirements.

Box 5.2. Conclusions from Convergence Reports

- Convergence Reports concerning the assessment of the degree of fulfilment of convergence criteria and institutional requirements by the different candidate states aspiring to the Euro-zone are prepared by the Commission and the European Central Bank every two years, or upon the request of a particular candidate country, on the basis of Article 122, item 2, of the Treaty establishing the European Community (TEC). The ten new member states have been assessed in convergence reports for the first time in October 2004 (such a report was prepared also for Sweden at that time). None of the assessed countries obtained a positive opinion of the Commission at that time.
- In 2006 Lithuania and Slovenia were again assessed in reports from May of the same year. This time, Slovenia was found to be a country that fulfilled the necessary conditions and was ready to join the Euro-zone from 1 January 2007 (which has actually happened). Lithuania, however, exceeded the threshold of acceptable inflation just slightly and maintained its status of a country with a derogation. In December 2006 the remaining countries were assessed again. Although in many countries there was progress in the implementation of the convergence criteria, none of them – according to the Commission – were ready yet to adopt the common currency.

Table 5.1. Fulfilment of convergence criteria by new member states – candidates to the Eurozone in early 2007.

	Inflation rate (HICP)	Budget deficit	Long-term interest rates	Public debt
Czech Republic	2.1	–2.9	3.68	30.4
Poland	1.3	–3.9	5.14	47.8
Hungary	4.0	–9.2	6.81	66.0
Slovakia	4.3	–3.4	4.15	30.7
Estonia	4.4	3.8	4.70	4.1
Lithuania	3.8	–0.3	4.28	18.2
Latvia	6.6	0.4	4.90	10.0
Cyprus	2.2	–1.5	4.26	65.3
Malta	2.6	–2.6	4.33	66.5
Bulgaria	7.4	3.3	4.18	22.8
Romania	6.6	–1.9	7.42	12.4
Reference value	**2.87**	**3**	**6.2**	**60**

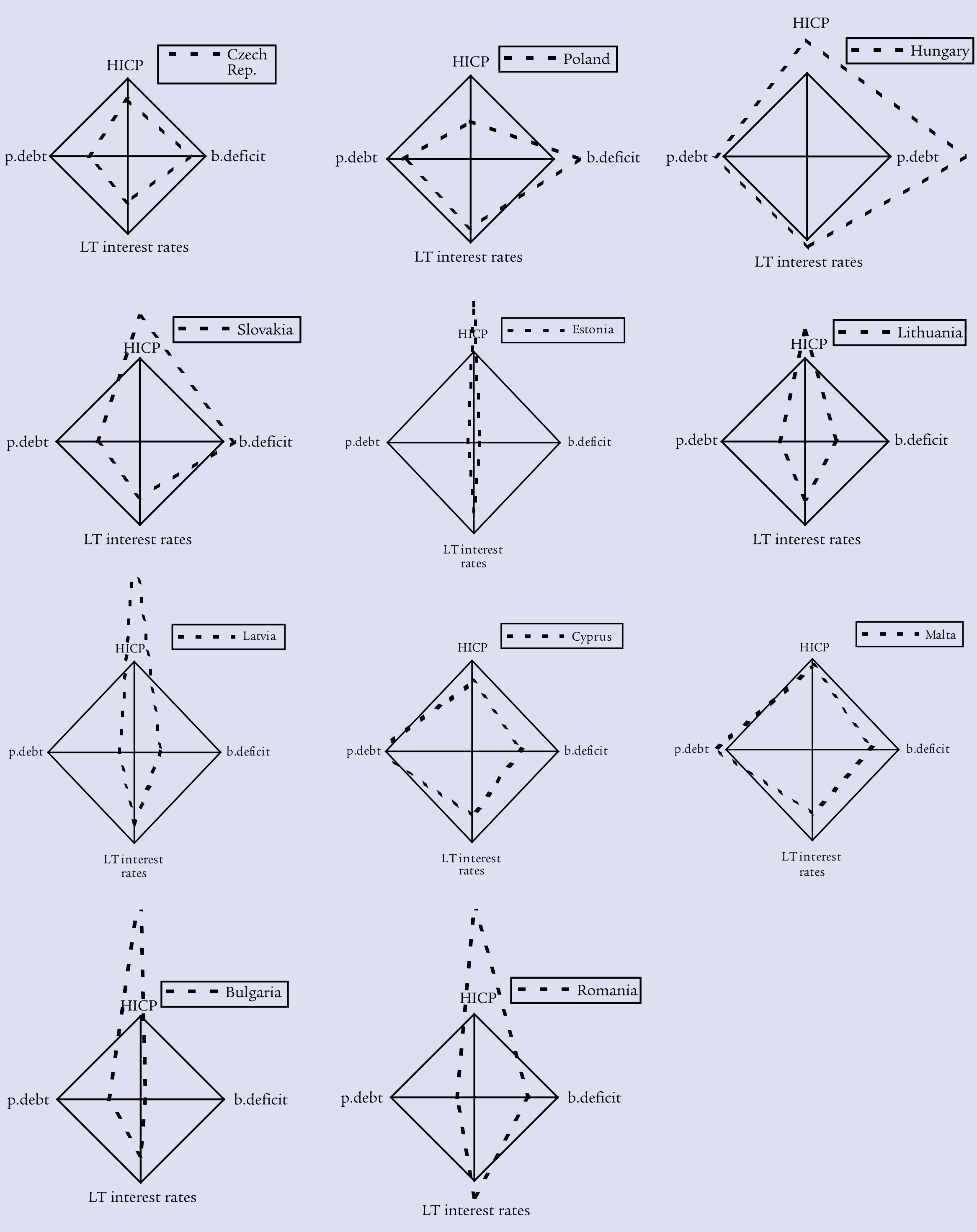
Assumptions used for the calculations:
1) All values comprise the average for the year 2006 (January-December).
2) The period January-December 2006 is the reference period for the calculation of the HICP reference value.
a. HICP reference value = non-weighted arithmetic value of three member states with the lowest HICP level plus 1.5 percentage points,
b. Three states with the lowest HICP level (January-December 2006) are: Finland -1.3%, Poland -1.3%, Sweden -1.5%
c. HICP reference value = 1.37% + 1.50 percentage points = 2.87%
3) The reference value of long-term interest rates was calculated as the arithmetic average of the value of interest rates in Finland, Poland and Sweden plus 2 percentage points, i.e. the reference value = 4.2% + 2.0 percentage points = 6.2%.

Source: Prepared by the Author based on EUROSTAT data.

[10] Data collected and graphs prepared by Łukasz Ambroziak.

[11] Convergence reports have been prepared since 1996 (at least every second year or upon the request of a country having a derogation; their procedure is determined by Article 122 (2) TEC). Reports prepared in 1998 provided the basis for the adoption of the decision – by the European Monetary Institute – concerning the qualification of EU members to the Eurozone. The Commission uses them to examines in detail whether the candidates fulfil the necessary conditions for adoption of the common currency, i.e. the convergence criteria and legal requirements.

Chart 5.2. Fulfilment of convergence criteria by the new member states at the beginning of 2007.



Source: Prepared by the Author based on data from EUROSTAT.

Only in May 2007 the Commission and the ECB decided that Cyprus and Malta had achieved the necessary degree of alignment of their macroeconomic situation with the convergence criteria, although in actual fact neither of them managed to fully meet the public debt criterion.

The degree of fulfilment of the convergence criteria by eleven new EU member states (Slovenia is in the Eurozone since January 2007) is illustrated in Table 5.1. The best situation prevails with regards to the level of public debt – only in three NMS countries such debt exceeds the admissible level of 60%, and two of them have already obtained the approval for entry to the Eurozone from January 2008[12] – and the level of long-term interest rates (two NMS do not fulfil this condition). The situation appears to be worse in the case of the deficit size, which exceeds the permissible limit of 3% of GDP in five NMS, and especially with respect to the inflation level, which exceeds the reference value in as many as seven NMS.

The degree of adaptation of the countries that are candidates to the Eurozone may also be presented in the form of quadrangles, each apex of which illustrates one of the four quantitative convergence criteria (it is not possible to fit in the degree of foreign exchange rate stability within the ERM II in such a graph). Such a presentation of the eleven NMS countries (excluding Slovenia) is shown in Chart 5.2.

The dashed lines in each quadrangle reflect the degree of achievement of the Maastricht criteria. Therefore, if for a given corner of the quadrangle the dashed line is outside of it, the respective criterion is fulfilled.[13]

It follows from the analysis of Chart 5.2 that none of the new EU member states (with the exception of Slovenia) meet all the Maastricht criteria. Cyprus and Malta are relatively closest, but they still have too high public debt in relation to the reference level (60% of GDP of any given country). Despite that, the Commission has recommended, on 16.05.2007, to admit Malta and Cyprus to the Eurozone from 1 January 2008.[14] In the convergence reports the Commission has found that both countries "have achieved a high level of *sustainable* economic convergence and were ready to adopt the Euro in January 2008". This proposal was approved by the EU Council of Ministers of Finance (ECOFIN) on 10 July 2007 (preliminary consent was expressed by the Council in session on 5 June 2007). Both countries will therefore enlarge to three the group of new EU member states, which actually get to join the Eurozone, and the whole Euroland will be enlarged to embrace 15 EU member states.

Box 5.3. Does the European Commission apply "double standards"? The degree of fulfilment of convergence criteria by Cyprus, Malta and Lithuania.

In its opinion of 16 May 2007 the Commission stated that Cyprus had fulfilled the necessary nominal convergence criteria. The rate of inflation over the last 12 months (until March 2007) amounted to 2.0% (reference value – 3.0%). The condition of public finance was undergoing evolution in the positive direction: it was estimated that the public finance deficit would amount to 1.4% of GDP in 2007, and public debt 61.5% of GDP (in 2006 it amounted to 65.3%). The Commission found that the interest rate and exchange rate criteria were also fulfilled.

In Malta, in turn, the ratio of public debt to GDP was reduced from 74% in 2004 to 66.5% in 2006, and in 2007 it should reach no more than 60%. The average rate of inflation over the last 12 months (until March 2007) amounted to 2.2%, i.e. it remained below the reference threshold (3.0%). The budget deficit for 2007 is estimated at the level of 2.1% of GDP.

The above indicated positive assessments of the Commission for Cyprus and Malta, despite the fact than none of these two countries fully complied with the public debt criterion, gave rise to discussion concerning the adequacy of the convergence criteria and the method of evaluation of their fulfilment. Suggestions also arose that the Commission was adopting different "standards" for different EU members, and its opinion was to a certain extent discretional. The case of Lithuania, which filed an application for membership in the Eurozone early on in 2006, was referred to in this context. This application was not received with positive acceptance by the European Commission and the ECB, because the rate of inflation in Lithuania exceeded the reference inflation rate level by (just) 0.1 percentage point.

Prepared based on:
http://ec.europa.eu/economy_finance/news/hotissues/2007/convergence_malta_Cyprus/main_en.htm

In 2007 Poland, Hungary, the Czech Republic and Slovakia are subject to the excessive deficit procedure and have determined deadlines for arriving at a lower deficit level.[15] Hungary is the state having the longest way to cover in order to meet the convergence criteria (see: Chart 5.2), as in 2007 it is the only NMS that does not meet any of the Maastricht criteria. Hungary, similarly as the Czech Republic and Poland, as well as Bulgaria and Romania, did not join ERM II. These countries have not even declared any timetable of steps in this direction, either owing to a difficult macroeconomic situation (Hungary), or due to cautious policy concerning the adoption of the common currency (Poland and the Czech Republic).[16] On the other hand, Slovakia is a country wishing to join the

[12] The Treaty allows entry to the Eurozone to countries having the debt level in excess of 60% of GDP, subject to the condition that the level of debt is declining and is approaching the reference level.

[13] For HICP, the public debt and interest rates, the beginning of the value axis (the middle of the quadrangle) consists of the number "0", whereas the apexes of the angles have values that are the reference values (HICP – 2.87%, interest rates – 6.2%, public debt – 60%; the inflation rates and interest rates were calculated as averages for the year 2006). In the case of a budget deficit, the beginning of the axis (middle of the quadrangle) consists of the value "4" (as the largest surplus was reported by Estonia – plus 3.8% GDP), and the tip of the angle is a reference value – minus 3%. Detailed assumptions of the calculations are the same as those quoted under Table 5.1.

[14] http://ec.europa.eu/economy_finance/news/hotissues/2007/convergence_malta_Cyprus/main_en.htm

[15] http://ec.europa.eu/economy_finance/about/activities/sgp/edp_list_en.htm

[16] In Poland, in the spring of the current year, a unit for the preparation of a new report on the benefits and costs of adoption of the Euro by Poland was formed at the National Bank of Poland. This suggest that the national authorities are not interested, at least for the time being, in joining the Eurozone in the next few years.

Table 5.2. Structural funds and Cohesion Fund financing available for the new member states of the EU for the years 2004-2006 (commitments for appropriations, in Euro millions and %, 2004 prices).

States	Objective 1	Objective 2	Objective 3	Interreg	Equal	Structural funds total	Cohesion Fund	Structural funds and Cohesion Fund total	Structure by country (%)	EUR *per capita* in 2004-2006
	1	2	3	4	5	6 = (from 1 to 5)	7	8 = 6+7	9	10
Cyprus	0.0	28.0	22.0	4.3	1.8	56.1	53.9	113.4	0.5	155.3
Czech Republic	1 454.3	71.3	58.8	68.7	32.1	1 685.2	936.0	2621.2	10.7	256.7
Estonia	371.4	0.0	0.0	10.6	4.1	386.1	309.0	695.1	2.8	514.5
Lithuania	895.2	0.0	0.0	22.5	11.9	929.6	608.2	1 537.7	6.3	446.2
Latvia	625.6	0.0	0.0	15.3	8.0	648.9	515.4	1 164.3	4.8	502.0
Malta	63.2	0.0	0.0	2.4	1.2	66.8	21.9	88.7	0.4	221.8
Poland	8 275.8	0.0	0.0	221.4	133.9	8 631.1	4 178.6	12 809.7	52.4	335.4
Slovakia	1 041.0	37.2	44.9	41.5	22.3	1186.9	570.5	1757.4	7.2	326.7
Slovenia	237.5	0.0	0.0	23.6	6.4	267.5	188.7	456.3	1.8	228.6
Hungary	1 995.7	0.0	0.0	68.7	30.3	2 094.7	1 112.7	3207.4	13.1	317.0
Total	**14959.6**	**136.5**	**125.7**	**478.9**	**252.0**	**15 952.9**	**8 494.9**	**24 447.8**	**100.0**	**329.8**

Source: Inforegio Newsletter January 2004.

Eurozone promptly – it is planning this move for the year 2009. Ambitious plans were also set by Lithuania, Latvia and Estonia, but these countries fell victim to their own economic success. They are developing so fast that inflation exceeds the presently acceptable rate of 3% per annum.[17]

5.4. STRUCTURAL SUPPORT FROM THE EU BUDGET FOR THE NEW MEMBER STATES[18]

5.4.1. Structural funds from the EU budget for the new member states in the EU budget in 2004-2006

From the moment of accession until the end of 2006 the amount and structure of structural funds, alternatively referred to here also as European funds (comprising: structural funds, Community Initiatives and the Cohesion Fund), for all EU countries, including the new member states (NMS), was determined on the basis of the Financial Perspective in force for the years 2000-2006. Owing to the fact that almost all the NMS represent much lower affluence levels in comparison to the EU-15, they are eligible for all the types of structural support available from the EU and financing from all the structural funds as well as the Cohesion Fund.[19] For the period 2004-2006, the ten NMS have obtained almost 16 billion Euro from the structural funds and 8.5 billion Euro under the Cohesion Fund. The greatest beneficiary of these funds in absolute terms was Poland, as the largest state within that group – Poland is eligible to 52.4% of the total allocations of commitments for appropriations for all the NMS. The magnitude and structure of these funds is presented in Table 5.2 and Chart 5.3.

If we look at the magnitude of the considered transfers to NMS taking into account the number of inhabitants, it turns out that the greatest amounts per capita are received by the three Baltic States: Estonia, Latvia and Lithuania – accordingly approximately EUR 514-450 per inhabitant over the first three years of EU membership, i.e. the years 2004-2006 (Table 5.2).[20]

In the middle of 2007 data concerning the utilisation of the structural funds were available as at the end of the year 2006. Owing to the multi-annual nature of most measures implemented using the funds under discussion, the full evaluation of their absorption will be possible only in a few years time (in most cases in 2009), when the full cycle of implementation and evaluation of the allocated funds will be completed. It will then be possible not only

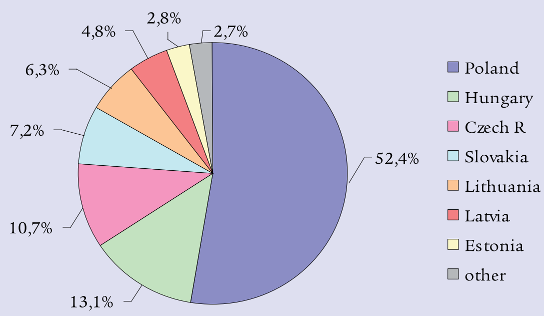
[17] High inflation in the Baltic states is above all the consequence of the so called Balassy-Samuelson effect, which causes the growth of inflation in the sector of services due to rapidly growing labour efficiency and rapidly rising wages in the manufacturing sector, under the conditions of a fixed foreign exchange rate.

[18] The statistical data, the tables and graphs were prepared by Łukasz Ambroziak. The analysis covers the ten new member states, which joined the EU from 1 May 2004 (EU-10).

[19] These are only funds for structural measures, and therefore they do not comprise additional sums for other measures, including internal policies, direct payments for farmers, etc. Information concerning gross and net clearing of total funds received from the EU budget is contained in Section 5.5.

[20] In the period until the end of 2006 the new member states also used pre-accession funds. These amounts are omitted in this analysis, because full data concerning them are not yet available.

Chart 5.3. Structural funds and Cohesion Fund allocations for new member states 2004-2006 (%, 2004 prices).



Source : Inforegio Newsletter January 2004.

to consider the (fully) realised projects, but also to possibly eliminate those, which were implemented without complying with the agreed objectives and procedures.

It is obvious that the structural funds constitute a great chance for the acceleration of economic development of the new member states and the reduction of the gap separating them from the countries of the "old" Union. This results from several functions fulfilled by these funds. Above all, they create the possibilities of essential addition to local capital and of increasing the outlays for economic and social development, including very capital intensive investment in the domain of protection of the environment and transport infrastructure, as well as the modernisation of the economy. The significance of such financing is indicated, i.a., by the fact that in accordance with the rule in force over the years 2000-2006 – beneficiaries (regardless of whether they came from EU-15 or EU-10 countries), could receive up to 4% of their GDP in the form of structural funds[21] (since 2007 this ceiling was somewhat reduced and differentiated depending on the level of economic development of the beneficiary). At the same time, these funds play the role of mobilising national funds for development, due to the requirement of co-financing on the part of the beneficiaries of the EU funds. The actual application of funds for development is therefore greater than what the allocation of EU funds alone would indicate. Moreover, the EU funds drive investments that enhance development, i.e. the improvement of economic and social infrastructure, the increase of competitiveness of business enterprises and entire sectors, as well as the development of human capital. They cannot be spent on current consumption. At the same time, structural funds push for change of social and economic structures, stimulating the growth of activity of the entities using the support measures, enhancing their entrepreneurial initiative, promoting closer cooperation between the public and the private sector in solving development related problems of the regions, etc.

5.4.2. Utilisation of structural funds

The year 2006 was a significant period of implementation of cohesion policy in those countries, which joined the EU in 2004. It was the first year of formal settlement of accounts concerning the financial progress made with the use of structural funds. At the end of 2006, for the first time, one of the basic rules of financial management of the structural funds was applied – the so called "n+2" rule. According to this rule, the amount of funds allocated for the implementation of the programmes for 2004 had to be cleared by the end of the year 2006 (until the end of the year 2006 this rule applied only to structural funds and did not apply to the Cohesion Fund).[22] Therefore, a state, which by the end of 2006 would submit applications to the Commission for payments concerning lower amounts than the allocation for 2004, would irretrievably lose the amount of the difference. Analysis of the implementation of the "n+2" rule indicates that almost all the funds allocated to the ten new member states for the year 2004 were actually used. According to the data from the European Commission, amongst the new EU countries only Slovakia (and more precisely its Bratislava region) failed to fully utilise the funds available for the year 2004 (however, this concerned only a small amount, corresponding to approximately 0.1% of the allocation for that country for the year 2004).[23]

Nevertheless, this does not imply any guarantee of a high degree of absorption of all structural funds in the foreseen time frame.

Chart 5.4. presents a comparison of the cumulative index of absorption of structural funds (payments) for the end of the year 2006, calculated by two different methods. The grey columns represent the refunding, and

[21] This ceiling did not concern other kinds of support from the general EU budget, e.g. market support in agriculture.

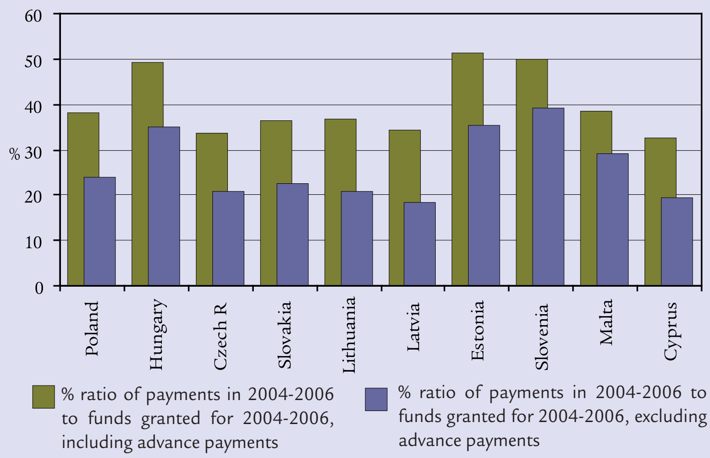
[22] The n+2 rule was only introduced in the year 2000. It is supposed to enhance the efficiency of utilisation of structural funds, forcing the beneficiaries to implement the measures co-financed from European funds in a possibly prompt and timely manner. In the new Financial Perspective for 2007-2013 this rule applies not only to structural funds, as was the case before, but also to the Cohesion Fund. At the same time, the period for spending the funds was extended, applying the n+3 rule, but only for the years 2007-2010.

[23] D. Szczechowski, Realizacja unijnej polityki spójności w Polsce w 2006 r. na tle innych państw członkowskich. Biuletyn Informacyjny Fundusze Structuralne w Polsce, nr 9/2007 [Implementation of EU cohesion policy in Poland in 2006 in comparison to other member states, Information Bulletin on Structural Funds in Poland, No 9/2007]; http://www.funduszestructuralne.gov.pl/NR/rdonlyres/90 360D73-268F-4F5B-93A0-7848B204F598/31485/BiuletynFSnr 91.pdf

therefore just the reimbursement to the member states by the European Commission of sums actually spent by the beneficiaries of the funds (based on invoices). The black columns (13-16% higher), in turn, inform about the magnitude of the refunds together with the disbursed advance payments. Even such presentation of the absorption of funds demonstrates that in the first three years after the accession it is not high and only in three countries (Estonia, Slovenia and Hungary) it came close to 50% of the value of the funds allocated in the period of the previous Financial Perspective (2004-2006). Let us remember that in accordance with the "n+2" rule – beneficiaries of the structural funds have time only until the end of 2008 to settle the accounts concerning the allocated funds.

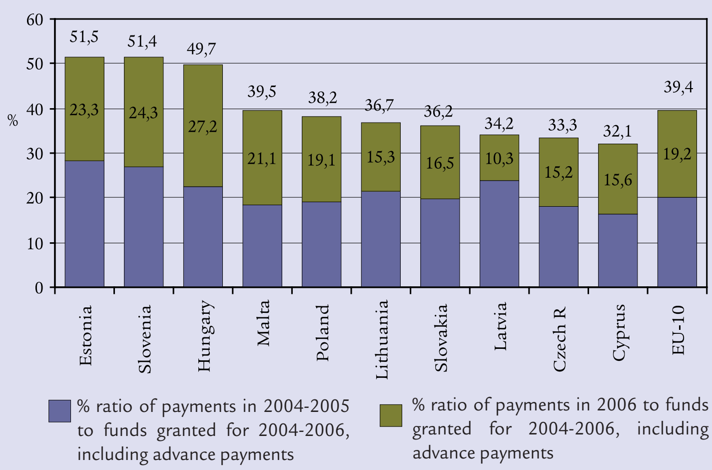
Chart 5.5 presents the ratio of payments to funds granted for the years 2004-2006, separately for the year 2005 and for the end of 2006. It indicates a significant acceleration of the disbursement of payments (amounts including the advances) in the year 2006. For many countries the total payments in 2006 were similar to those of the previous two years 2004-2006. The greatest acceleration of the implementation of projects financed from the structural funds was noted in Hungary, Slovenia and Estonia. At the same time, as already noted, these three countries were relatively the best in coping with the absorption of structural funds over the whole period of the initial three years of EU membership, utilising approximately 50% of their volume. The clearly lowest degree of absorption of the funds under discussion occurred in the Czech Republic and Cyprus – only at the level of approximately 33-32%. Poland found itself in the middle of that group with the ratio of 38%.

Chart 5.4. The degree of absorption of structural funds in the EU-10 (as the ratio of payments in the years 2004-2006 to funds granted for the years 2004-2006, expressed as a percentage) according to various estimates.



Source : Analysis of the budgetary implementation of the Structural Funds in 2006, European Commission, Brussels, June 2007; D. Szczechowski, Realizacja unijnej polityki spójności w Polsce w 2006 r. na tle innych państw członkowskich. Biuletyn Informacyjny Fundusze Structuralne w Polsce, nr 9/2007 [Implementation of EU cohesion policy in Poland in 2006 in comparison to other member states, Information Bulletin on Structural Funds in Poland, No 9/2007].

Chart 5.5. Cumulative payments at the end of 2005 and at the end of 2006 in relation to structural funds granted to the EU-10 countries for the years 2004-2006 (%)*



* Total height of the column represents the % ratio of payments in the years 2004-2006 to funds granted for the years 2004-2006, including advance payments;

Source: Analysis of the budgetary implementation of the Structural Funds in 2006, European Commission, Brussels, June 2007.

A true challenge for beneficiaries of the cohesion policy will consist of the absorption of funds in the years 2007-2008, when the application of funds granted for the cohesion policy programming period 2000-2006 should be completed, and at the same time the EU-10 countries will have gained access to new, much larger funds on the basis of the Financial Perspective for the years 2007-2013.

5.4.3. Utilisation of the Cohesion Fund

Apart from the structural funds, new member states also benefit from the Cohesion Fund resources. These amounts are rather substantial: on average they correspond to approximately 35% of the structural funds.

Table 5.3 illustrates the degree of utilisation of the Cohesion Fund at the end of 2006. It shows that the average ratio of utilisation of the Cohesion Fund in the

Table 5.3. Utilisation of the Cohesion Fund at the end of 2006 versus funds granted for the years 2000-2006*

Country	Funds granted for 2000-2006 (decided)	Total payments by end of 2006	Funds remaining to be used	Payments to funds granted ratio (%)
	1	2	3=2-1	4=2:1
Spain	11 833.1	7 524.5	4 308.6	63.6
Greece	2 813.1	1 244.0	1 569.1	44.2
Ireland	585.6	517.8	67.7	88.4
Portugal	3 153.2	1 585.6	1 567.6	50.3
EU-4	18 385.0	10 871.9	7 513.0	59.1
Cyprus**	54.0	18.8	35.2	34.8
Czech Republic	1 234.9	509.7	725.2	41.3
Estonia	430.6	169.3	261.2	39.3
Lithuania	825.9	294.3	531.6	35.6
Latvia	710.8	309.2	401.6	43.5
Malta**	22.0	4.9	17.0	22.5
Poland	5 635.4	1 442.2	4 193.2	25.6
Slovakia	766.5	317.5	449.0	41.4
Slovenia	254.3	93.8	160.5	36.9
Hungary	1 483.3	528.2	955.0	35.6
EU-10	11 417.7	3 688.0	7 729.7	32.3
Cohesion Fund Total	29 802.6	14 559.9	15 242.7	48.9

*Funds including ISPA
** Cyprus and Malta did not benefit from ISPA
Source: Data of the European Commission.

Table 5.4. Payments in the ISPA and Cohesion Fund framework for the new member states in 2006.

Country	Cohesion Fund	ISPA	Total payments			
				Cohesion Fund	ISPA	by country
	Euro millions	Euro millions	Euro millions	%	%	%
Cyprus	6.0	0.0	6.0	100.0	0.0	0.4
Czech Republic	216.1	56.2	272.3	79.4	20.6	19.0
Estonia	54.8	25.8	80.7	68.0	32.0	5.6
Lithuania	52.4	35.1	87.4	59.9	40.1	6.1
Latvia	75.1	36.0	111.0	67.6	32.4	7.8
Malta	2.6	0.0	2.6	100.0	0.0	0.2
Poland	349.7	179.5	529.2	66.1	33.9	37.0
Slovakia	77.1	38.6	115.7	66.6	33.4	8.1
Slovenia	33.0	5.2	38.2	86.5	13.5	2.7
Hungary	137.3	56.8	194.1	70.7	29.3	13.6
EU-10	998.1	433.1	1431.2	69.7	30.3	100.0

Source: Data of the European Commission.

new EU member states is rather low; at the end of 2006 it averaged 32%. It was highest in Latvia, Slovakia and the Czech Republic (approximately 40%), and lowest in Poland (ca. 26%) (Cyprus and Malta were omitted from the analysis). The analogous ratio in the cohesion countries of the "old" Union was much higher, as it averaged 59% there. Of course, such proportions reflect the much better preparedness of the "old Union" countries for the absorption of EU funds, in comparison with the new member states.

The actual ratio of utilisation of the Cohesion Fund is even lower in the new EU countries. The data in Table 5.3. take into account the total funds of the Cohesion Fund and of the *Instrument for Structural Policies for Pre-Accession* (ISPA), available for candidates to the EU from the beginning of the year 2000. The funds of this programme that were not utilised until the time of accession were included in the Cohesion Fund. In 2006, and therefore in the seventh year of implementation of ISPA, the funds of that programme still represented – on average – as much as 1/3 of total payments in the framework of the Cohesion Fund discussed here (Table 5.4). This suggests very slow application of these funds.

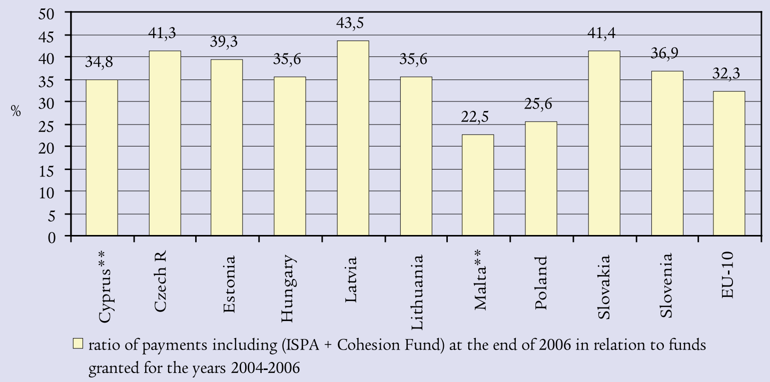
It should be objectively admitted that the launching of investments financed from the Cohesion Fund takes longer than in the case of investments of other kinds (e.g. modernisation of business enterprises, financed from the European Regional Development Fund). This results, above all, from greater scope of investments in the Cohesion Fund framework (national significance) and the related large scale capital expenditure, more documentation necessary to launch projects (e.g. in the case of infrastructure projects it is required to prepare an environmental impact assessment for the given investment project).

5.4.4. European funds for new EU member states in 2007-2013

In the new cohesion policy programming period, i.e. in the years 2007-2013, funds for the support of economic and social development as well as structural measures in the new member states increased substantially. Out of the total amount of EUR 308.0 billion (in 2004 prices), foreseen for that policy in the period 2007-2013, almost 44% of the financing will go to the 10 new member states (without Bulgaria and Romania).

In the years 2004-2006 the analogous share of the EU-10 was only 23%. Bulgaria and Romania will receive approximately 7.6% of total funds for cohesion policy, which implies that in the analysed period the 12 new member states of the Union will get slightly more than half (51%) of the EU cohesion policy budget (Table 5.5). It is worth adding that this entire budget for 27

Chart 5.6. Utilisation of the Cohesion Fund and ISPA in the New EU member states at the end of 2006 compared against the funds allocated for the years 2004-2006 (%, current prices)*



* funds allocated jointly with ISPA
Source: Data of the European Commission.

Table 5.5. Indicative allocation of financing for structural measures between the new member states of the EU in the period 2007-2013 (Euro millions, 2004 prices)

	Goal 1			Goal 2		Goal 3	Total	
	Cohesion Fund	Goal 1	phas-ing out	phas-ing in	Goal 2		Euro millions	%
Czech Republic	7 830	15 149			373	346	23 697	7.7
Cyprus	194			363		25	581	0.2
Estonia	1 019	1 992				47	3 058	1.0
Lithuania	2 034	3 965				97	6 097	2.0
Latvia	1 363	2 647				80	4 090	1.3
Malta	252	495				14	761	0.2
Poland	19 562	39 486				650	59 698	19.5
Slovenia	1 239	2 407				93	3 739	1.2
Slovakia	3 433	6 231			399	202	10 264	3.3
Hungary	7 589	12 654		1 865		344	22 452	7.3
Bulgaria	2 015	3 873				159	6 047	2.0
Romania	5 769	11 143				404	17 317	5.6
EU-12 total							157 791	51.3
EU-15	9261	77040	12522	8159	37971	4899	149 848	48.6
Not allocated						392	392	0.1
TOTAL	61 558	177 083	12 521	10 385	38 742	7 750	308 031	100.0

Source: Compiled by the Author based on: Fourth progress report on cohesion: Growth and jobs and the Reform of European cohesion policy, European Commission, Brussels 2006 [COM(2006) 281 final], http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/pdf/interim4/annex4inter_en.pdf

for the Cohesion Fund, whereby most of that pool (72.3%) will go to the new member states.[24]

In the present Financial Perspective the financing from structural funds will be mostly channelled to the poorest regions. The criterion here, similarly as in the period of the previous Financial Perspective, consists of the per capita GDP in a NUTS 2 level region (GDP is calculated at purchasing power parity) at a level not exceeding 75% of the EU average.[25] Starting from 2007, the beneficiaries of Objective 1 of regional policy convergence are: the entire territory of Bulgaria, Estonia, Latvia, Lithuania, Malta, Poland, Romania, Slovenia, and the poorer regions of Slovakia, the Czech Republic and Hungary. It is also anticipated that *phasing – out* funding will be provided for those regions, which have lost the entitlement to support resulting from enlargement, as the absolute level of GDP/per inhabitant in the EU has decreased (the so called statistical effect regions).

In the present structural funds programming period the number of financial instruments earmarked for cohesion policy has been reduced from six to three[26]; presently they comprise the European Regional Development Fund, the European Social Fund and the Cohesion Fund. Some of the procedures and documentation required to apply for support

member states constitutes about 36% of the overall budget of the European Union in terms of allocation of commitment appropriations and 0.37% of GNI of the EU-27.

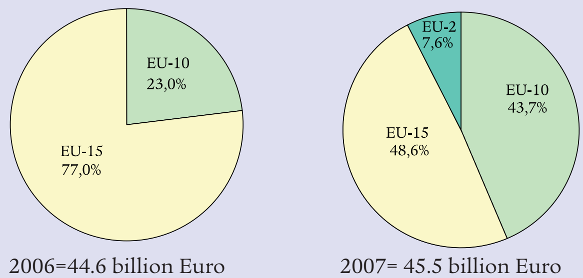
The largest beneficiary of cohesion policy in 2007-2013 will be Poland, which will be provided with almost EUR 60 billion, i.e. 44.4% of the funds earmarked for this policy for the EU-10 and 19.5% of total cohesion policy funding in the EU-27 (Table 5.5 and Chart 5.8). About 1/5 of total structural funds in the EU budget is destined

[24] Amongst the old member states of the EU Portugal and Greece are beneficiaries of the Cohesion Fund, as their per capita *Gross National Income* (GNI) is still below 90% of the average per capita income in the EU-27. Spain, however, enjoys the so called phasing out support. It is foreseen for countries which have lost eligibility to obtain these funds due to the statistical reduction of GNI per capita as a consequence of enlargement of the Union by less affluent countries.

[25] In the countries of the old EU a large part of the cohesion policy funding will be destined for innovative actions.

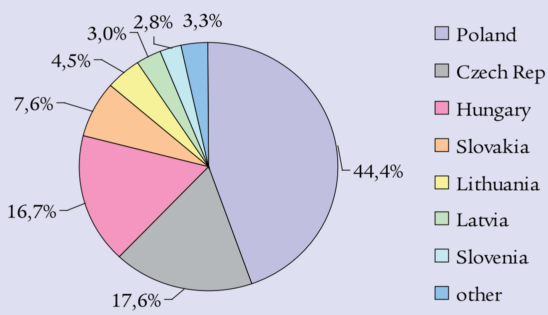
[26] Community Initiatives and innovative measures were included in priority operating programmes. Rural development was excluded from the cohesion policy and is financed mainly from the newly formed European Agriculture and Rural Development Fund. The Financial Instrument for Fisheries Guidance was replaced by the European Fishery Fund.

Chart 5.7. Comparison of the allocation of cohesion policy funds between the "new" and "old" member states in 2006 and 2007 (current prices).



Source: Website of Commissioner Dalia Grybauskaité, in charge of financial programming and the budget, http://ec.europa.eu/commission_barroso/grybauskaite/index_en.htm

Chart 5.8. Distribution of cohesion policy funding in the EU-10 (share of different countries in total funds earmarked for the EU-10)



Source: Compiled by the Author based on Table 5.8.

funding have been simplified. The n+2 rule, which requires the country of the beneficiary to utilise the structural funds within two years from their granting at the latest, was extended also to apply to the Cohesion Fund. At the same time, this rule was made more flexible. Temporarily, i.e. in the period 2007-2010, the "n+3" rule will be applied to the less wealthy states.

It is estimated that the financial support obtained from support funds provided from the EU budget will reach approximately 3.5% -3.9% of the GDP in the EU-10. In relative terms, Latvia will gain most – 3.9% GDP, followed by Poland, which is to be second in terms of the ratio of support funding to its GDP – approximately 3.8% of GDP. The receipt of such massive funding is a great opportunity for development and modernisation of the economies of the new member states and closing of the gap dividing them from the most affluent EU members. The utilisation of these funds, however, will require significant improvement of the absorption capacities of the economies of the beneficiary countries.

5.5. SETTLEMENTS OF ACCOUNTS OF THE NEW EU MEMBER STATES WITH THE COMMUNITY BUDGET IN 2004-2005

Since the accession, all the new member states (NMS) are net beneficiaries in their accounts with the EU budget (Table 5.6. and Chart 5.9). In most countries the net transfers in 2005 were greater than one year earlier. The only exceptions were the Czech Republic and Slovenia, which resulted from the fact that in both countries payments to the EU budget in 2005 increased more than the transfers from that budget. In absolute terms, the greatest amounts (both in gross and net terms) are received by Poland, which is the largest country in this group. If we compare the net transfers to the size of the population, however, it turns out that in per capita terms the beneficiaries receiving most support are Malta, Lithuania, Estonia and Latvia.

In 2005 the smallest net transfers per inhabitant were received by the Czech Republic, and also by Poland, Slovakia, Slovenia and Hungary. This resulted mainly from lesser advancement of these countries in the utilisation of structural funds and the Cohesion Fund, because the payments of contributions to the EU budget in per capita terms were much less differentiated. In the light of the presented data it may be concluded that the apprehensions expressed prior to the accession, that the new member states might become net payers to the EU budget, due to their incapacity to absorb the large amounts of structural funds, turned out to be unjustified. Moreover, the presented data demonstrate that the balance of transfers would have been favourable to the NMS even after deduction of the amounts contributed to the EU as part of the so called budgetary compensation, which was intended to enhance the liquidity of the national budgets during the initial years following the accession.

5.6. INTEGRATION OF BULGARIA AND ROMANIA WITH THE EUROPEAN UNION[27]

5.6.1. Accession of Bulgaria and Romania to the EU

The decision concerning the accession of Bulgaria and Romania to the EU from 1.01.2007 was adopted, as expected, in September 2006, after the publication of the

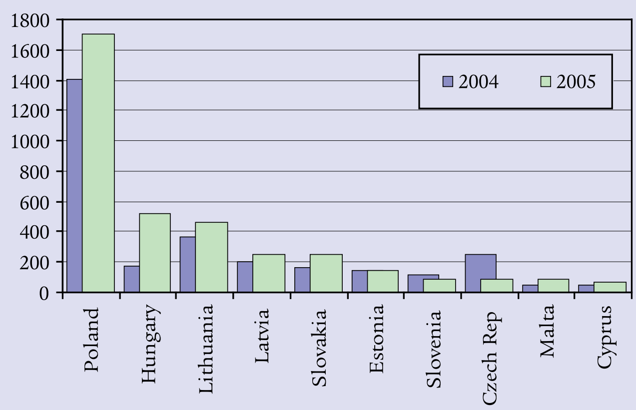
[27] Tables and graphs to this chapter were prepared by: T. Woźnicki.

Table 5.6. Net financial accounts of new EU member states (EU-10) with the EU budget in 2004-2005 (Euro millions; and Euro/*per capita*)

	Transfers from EU budget		Contributions to EU budget		Balance of the accounts			
	Euro millions		Euro millions		Euro millions		Euro/*per capita*	
	2004	2005	2004	2005	2004	2005	2004	2005
Cyprus	147	215	95	150	52	65	69.7	87.0
Czech Republic	815	1075	565	990	250	85	24.5	8.3
Estonia	202	249	55	100	146	149	108.6	110.6
Lithuania	487	666	119	207	368	459	107.4	133.9
Latvia	267	385	68	130	199	255	86.4	110.6
Malta	78	135	33	50	45	85	112.7	209.9
Poland	2720	4029	1311	2327	1409	1702	36.9	44.6
Slovakia	388	609	220	359	168	250	31.2	46.5
Slovenia	281	366	171	275	111	91	55.5	45.7
Hungary	713	1357	537	833	176	524	17.4	51.9
EU-10	6098	9085	3173	5421	2925	3664	39.5	52.9

Source: Compilation by the Author based on: Financial Report 2004, European Communities, Luxembourg 2005, http://ec.europa.eu/budget/library/publications/fin_reports/fin_report_04_en.pdf; Financial Report 2005, European Communities, Luxembourg 2006, http://ec.europa.eu/budget/library/publications/fin_reports/fin_report_05_en.pdf; Allocation of the EU expenditure by Member State, European Commission, 2006; http://ec.europa.eu/budget/library/documents/revenue_expenditure/agenda_2000/allocrep_2005_en.pdf;

Chart 5.9. Net accounts of the new EU member states (EU-10) with the EU budget in 2004-2005 (Euro millions)



final report of the European Commission on the state of their preparation for accession. At the same time, both these countries were obliged to bring the reforms indicated in the report to completion.

The progress of reforms in both countries is still closely monitored. In the case of Romania the fields scrutinised by the European Commission consist of the system of justice and combating corruption, the integrated system of administrative controls in the area of agriculture, and the consistency of the taxation system. In the case of Bulgaria, apart from the system of justice and combating of corruption, monitoring is extended over combating of organised crime and money laundering.

According to experts, already one year before the date of the last enlargement, most persons responsible for this process in the EU were aware that both countries were not able to fulfil all the conditions for membership of the EU.[28] They pointed at the discrepancies between the declarations of Bulgarian and Romanian politicians and the realities prevailing in their countries. As a result of discussions concerning these issues the Accession Treaties were provided with clauses serving to assure the completion of specific reforms. Delays in their implementation could cause the blocking of the access of both of these countries to EU support funds and certain restrictions in exports to member states of the EU. Nevertheless, it remains to be seen how effective this method of assuring disciplined behaviour of these two countries will turn out to be in practice.

5.6.2. Trade between Bulgaria and the EU

In the years 2003-2006, and therefore in the last phase of preparations of Bulgaria for EU membership, the deficit in trade with the EU was systematically increasing – in 2006 the ratio of such trade deficit to GDP reached 13.5%. It is worth noting, however, that in the same year, and therefore just before the accession, exports to the EU increased in relation to the year 2005 by almost 5 percentage points faster than imports from the EU. Yet, the average annual growth rates of imports (17.2%) and exports (17.3%) over the years 2003-2006 were almost identical. Persistence of this trend after joining the EU should be regarded as a favourable change in the structure of trade exchange. As a matter of comparison, the data for the period of 10 years (1995-2005) indicate 14% average annual growth of exports and 17% average annual growth of imports (Table 5.7. and Chart 5.10).[29]

[28] G. Noutcheva, Bulgaria and Romania's Accession to the EU: Postponement, Safeguards and the Rule of Law, CEPS Policy Brief, No 102/May 2006

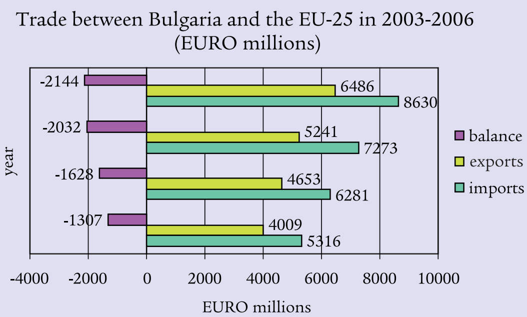
[29] W. Mroczek „Handel Unii Europejskiej z Bulgarią i Rumunią" [EU Trade with Bulgaria and Romania], Wspólnoty Europejskie Nr 1 luty 2007 [European Communities, No 1, February 2007].

Table 5.7. Trade turnover between Bulgaria and the EU-25 in 2003-2006 (Euro millions)

Year	Imports	Annual change	Exports	Annual change	Balance
2003	5316		4009		–1307
2004	6281	18.1%	4653	16.0%	–1628
2005	7273	15.1%	5241	12.6%	–2032
2006	8630	18.6%	6486	23.7%	–2144

Source: Compiled by the Author based on Eurostat data.

Chart 5.10. Trade between Bulgaria and the EU-25 in 2003-2006



Source: Prepared by the Author based on Eurostat data.

In the year 2005 the share of the EU-25 in the exports of Bulgaria amounted to 57% and in imports 50%. The high growth rate of the volume of trade between Bulgaria and the EU contributed to the increase of the share of that country in the trade turnover of the EU.[30] Just before the enlargement, Bulgaria ranked as the thirty seventh trading partner of the EU amongst third countries.

The highest position in trade of EU member states with Bulgaria is occupied by Germany (first place in imports) and Italy (first place in exports). The dominant countries in total exports and imports of Bulgaria are Turkey (11% of Bulgaria's total exports and 5% of imports in 2005) and Russia (16% of total imports in 2005). Perseverance of this structure in the future could lead to the growth of significance of these two countries in the external trade of the EU. The increase of the growth rate of EU trade with Russia is regarded by some experts as a long-term benefit of the admission of Bulgaria to the EU.

In terms of the structure of goods exchanged in trade between Bulgaria and the EU-25, the largest share in exports (60%) is held by articles with a low degree of processing and high raw material input, such as textiles and metallurgical products, whereas machinery and transport equipment represent only 14% of Bulgarian exports to the EU. In the initial years of Bulgaria's membership one should not expect any radical changes in the commodity composition of its trade with the EU, which is typical of fast growing economies with a production structure that is not very modern. It seems that more clear changes in this area will occur over a longer period of time, as the result of more dynamic inflows of foreign investment.

[30] Ibidem.

5.6.3. Trade between Romania and the EU

During the period 2003-2006 imports to Romania from the EU-25 grew at the average annual rate of 21.3% and exports at the rate of 14.9% (see: Table 5.8 and Chart 5.11). The difference between the rate of change of exports and imports over the period under consideration was much greater than in the case of Bulgaria. In the preceding years (1996-2005) the average annual growth rates of Romanian exports and imports amounted to 17% and 18% respectively, so the difference was much lesser than in the period immediately after the enlargement.

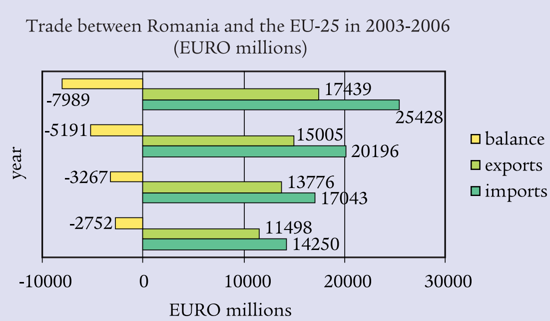
In the period 2003-2006, the deficit in trade between Romania and the EU increased over three times. A particularly wide gap between the growth of exports and imports occurred in the years 2004-2006, and therefore just before obtaining the membership of the EU. In 2006 the ratio of such trade deficit to GDP was at the level of 10.3%. In the future it should rather be expected that the high deficit in trade between Romania and the EU will persist, owing to its structural nature.

Table 5.8. Trade between Romania and the EU-25 in 2003-2006 (EURO millions)

Year	Imports	Annual change	Exports	Annual change	Balance
2003	14250		11498		–2752
2004	17043	19.6%	13776	19.8%	–3267
2005	20196	18.5%	15005	8.9%	–5191
2006	25428	25.9%	17439	16.2%	–7989

Source: Compilation by the Author based on Eurostat data.

Chart 5.11. Trade between Romania and the EU-25 in 2003-2006



Source: Compilation by the Author based on Eurostat data.

In 2005 the share of the EU-25 countries in Romania's exports amounted to 68%, and in imports to 62%; as a matter of comparison, corresponding shares in the year 1995 were 59% and 56%, respectively. Similarly as in the case of Bulgaria, the relatively fast growth of the volume of trade with the EU generated the growth of the share of Romania in the trade turnover of the EU. Romania occupied the thirteenth position on the list of third country trading partners of the EU, which was much higher than in the case of Bulgaria. Similarly as in the case of Bulgaria, the most important trading partners of Romania are Turkey (6% of total imports and 8% of total exports) and Russia. In the case of Romania's trade with the EU-25, it is Germany and Italy that predominate.

The commodity structure of trade between Romania and the EU is similar to the structure of EU trade with Bulgaria. Imports from the EU are dominated by machinery and transport equipment, exports are dominated by textiles and other less intensively processed goods.

5.6.4. Financial support from the EU granted to Bulgaria and Romania

Both these countries belong to the group of eight member states, where the GDP per capita is below 60% of the average GDP per capita of the EU-27. Therefore, all the regions of Bulgaria and Romania are covered by financial support as part of the regional policy of the EU.

Both Bulgaria and Romania have prepared the programmes required by the European Commission, containing a set of priorities, objectives and measures financed from European funds, as well as the analysis of expected effects of structural funds and concerned with economic growth, the level of unemployment, inflows of foreign investment, the degree of competitiveness of business enterprises. According to most recent estimates, cash flows from support transfers in 2007-2013 may generate at least 2% GDP growth. The condition for the achievement of such results, however, consists of proper utilisation of EU support funds.

Experts point out that the degree of preparedness of the administration for the efficient absorption of EU funds is insufficient in both countries. The list of the respective deficiencies includes: the shortage of sufficiently qualified civil servants, shortage of skills in programming and utilisation of funds, delays in the development of information technology systems for monitoring the process of submission and implementation of projects. Similarly as in the case of Poland and other countries of Central Europe, the initial years of EU membership will be of key significance for the improvement of efficiency of procedures, the conduct of the appropriate amount of training and furnishing possibly complete information on the available opportunities of obtaining European co-financing for the implementation of projects.

In the framework of the current EU budget (for the years 2007-2013) Bulgaria will be able to draw EUR 6.853 billion from the EU structural funds. This amount is almost three times greater than the funds granted in the years 2001-2006 (EUR 2.175 billion). Almost two thirds of this amount (65.7%) consist of funds originating from the European Social Fund and the European Regional Development Fund. According to the development strategy prepared by the government of Bulgaria, these funds will be applied for purposes connected with the adaptation of Bulgarian economy to the economies of EU countries (promotion of investment, growth of innovativeness of the economy, information society development). The remaining part of the funds (34.3%), mainly from the Cohesion Fund, will be utilised for investment in infrastructure and protection of the natural environment.

In the period of 1992-2003 Romania received approximately EUR 600 million per year as part of pre-accession aid, although in the two years immediately preceding its entry to the EU these amounts were much higher: 2005 - EUR 960 million, 2006 – over EUR 1 billion. In the structural funds framework for 2007-2013 Romania has been granted the amount of EUR 19.668 billion, including funds for the development of agriculture and fisheries totalling close to EUR 29 million.

5.7. THE WESTERN BALKANS: REGIONAL COOPERATION AND ECONOMIC INTEGRATION WITH THE EUROPEAN UNION[31]

5.7.1. Economic cooperation within the region of the Western Balkans

In the course of the year 2007 further progress was made in the creation of institutional foundations for regional cooperation between the states of the Western Balkans. The initiative set up in 1998 under the name of the Stabilisation Pact for South-Eastern Europe was transformed in May 2007 into the Regional Cooperation Council. Hido Biscevic, Secretary of State at the Ministry of Foreign Affairs and European Integration in the government of Croatia, became its first Secretary General. The establishment of this Council is regarded as proof of maturity of the region in restoring political stability and building up economic integration both with the EU and amongst the countries of this region. The Council will formally begin its activities in February 2008.

[31] Tables and charts to this chapter were prepared by T. Woźnicki.

The development of cooperation within the region is both an important and a difficult task. The EU countries and the European Commission regard integration within the region as an essential factor contributing to the stabilisation of the regional situation and speeding up the process of preparations for EU membership. Western Balkan countries support intra-regional integration in varying degrees, as they are afraid that it might replace or delay the successive EU enlargement. Moreover, regional integration is hampered by the economic disintegration of the region, which is a consequence of the war of the first half of the nineteen-nineties. The transport and energy supply infrastructure linking the different countries has been destroyed, cooperation faces obstacles resulting from unresolved issues of migrations of the population.

The Stabilisation Pact Initiative seems to be a good solution under such conditions. Above all, it has gathered at the same table on equal terms all the partners of the process: the countries of the Western Balkans, countries external to the region (Switzerland, Canada, Japan, Norway, Russia and the USA), member states of the EU, the European Commission, all the important international organisations and financial institutions. The basic form of activity consists of cyclically organised conferences devoted to issues of essential significance for regional cooperation, such as regional infrastructure and cooperation in the field of energy, trade and employment, migrations, combating organised crime. The World Bank and the European Commission were charged with the coordination of financial aid for the region. The countries, which have so far been partners of the Pact become members of the Council, whereas the source of financing for the secretariat of the Council will consist of funding coming from the EU and other countries.

A particularly important element of regional cooperation consists of the new agreement on the creation of a Central European Free Trade Area (CEFTA) – which entered into force in July 2006. This agreement replaced the complicated system of 32 bilateral agreements between the countries of South-Eastern Europe. The existing CEFTA members: Croatia and Macedonia were joined by the other states in the region: Albania, Bosnia and Herzegovina, Serbia, Montenegro, Moldova and Kosovo.[32] Integration in the CEFTA framework is regarded as a complementary initiative in relation to the Stabilisation and Association Agreements signed with particular countries of the Western Balkans and as an important step toward gaining EU membership.

The European Commission stresses its continuing financial and technical support for the process of liberalisation of trade within the CEFTA framework. Liberalisation will cover 90% of trade exchange, including 100% of the trade in industrial goods. It is expected that the stimulation of dynamic trade exchange within the region will contribute to the increase of foreign investment in the area, including investment coming from EU countries. The present level of foreign direct investment is low, the weak participation of foreign investors in the process of privatisation is especially worrying.

An important challenge for economic cooperation within the region consists of the development of common energy and transport infrastructure. The Agreement on the Common Energy Market of South-Eastern Europe was concluded in the year 2005 between the EU and the countries of the Western Balkans. The basic objectives of the Energy Community are: creation of a uniform legal framework for the whole of Europe and a stable legal and market environment, assurance of security of supplies, raising of environmental protection standards, increase of competition throughout the whole area, utilisation of the economies of scale. Implementation of this project will speed up structural reforms in the energy sector of the different countries in the region. Efforts are made to develop a unified mechanism of energy transmission and/or transportation, combined with the concurrent elimination of customs tariffs. Full liberalisation of energy trading will be introduced in 2008 for industrial customers and in 2015 for all other end consumers. The priority in the domain of transport consists of the system of connections between different countries of the Western Balkans, integrated with the European road network. Financing of the rebuilding and construction of regional infrastructure, however, must be accompanied by finding sources of financing for the running costs of particular investment projects. Shortage of such financing will constitute a serious barrier to the further development of the region.

Regional cooperation among the countries of the Western Balkans also has its political dimension. It constitutes an important element of restoring stability in this area, favouring the development of good neighbourly relations, assisting the overcoming of nationalism and intolerance. The political dimension plays an increasingly important role in the previously described strategy of EU enlargement; notwithstanding, the condition of completing the political reforms is contained in the clauses of the accession treaties of Bulgaria and Romania. It seems that the pace and quality of political and not economic reforms will above all be decisive for the admission of further successive countries to the EU.

[32] Agreement on Amendment of and Accession to the Central European Free Trade Agreement, http/www.stabilitypact.org/trade/CEFTAMAINTEXT2006.pdf

Table 5.9. Structure of exports of Balkan states to the EU and structure of exports within the region of the Western and Eastern Balkans in 2004 (%)

	Albania	Bosnia and Herz.	Croatia	Macedonia	Serbia and Montenegro	Romania	Bulgaria
EU-25	90.6	54.0	64.6	57.0	53.4	73.1	58.3
Including:							
Germany	3.3	11.3	11.2	18.9	6.3	15.0	10.2
Italy	73.1	15.8	22.9	8.0	14.2	21.4	13.1
Greece	12.0	0.5	0.2	13.7	4.3	2.7	9.9
Austria	6.3	4.6	9.4	0.5	2.5	3.1	2.2
Slovenia	0.3	8.4	7.5	1.6	4.2	0.5	0.3
Hungary	0.0	3.7	1.3	0.1	3.4	3.8	0.9
West.Balk.	1.7	37.6	19.3	28.9	28.5	2.5	5.7
Albania		0.2	0.3	1.4	0.6	0.1	0.4
Bosnia and Herz.	0.1		14.4	2.0	17.0	0.2	0.1
Croatia	0.1	20.4		4.8	4.1	0.8	0.4
Macedonia	1.2	0.8	0.9		6.8	0.5	2.1
Serbia and	0.4	16.2	3.7	20.8		1.0	2.7
Romania	0.0	0.1	0.9	0.1	3.3		4.0
Bulgaria	0.3	0.1	0.4	3.1	1.6	1.9	

Source: Comtrade.

5.7.2. Trade exchange within the region of the Western Balkans

The region of the Western Balkans is the second destination of exports of the countries of this region after the EU, whereas the share of Bulgaria and Romania in their exports is very low. Such a structure of exports is evidence of the strong historical economic links within the region, which are reinforced by the network of bilateral agreements on the liberalisation of trade. The recently enlarged free trade zone CEFTA should additionally intensify the trade exchange in the Western Balkan region. Data presented in Table 5.9 indicate also the strong bilateral concentration of exports of the different countries.

It is difficult to forecast today, what changes in bilateral relations will take place in the future. Countries belonging to CEFTA are at a similar stage of development, but their degree of preparation for EU membership varies. It seems that it is still too early to foresee, which integration effects will be stronger: those based on the process of association with the EU, or those resulting from connections in the framework of regional integration.

5.7.3. Trade between Western Balkan countries and the European Union

The main trading partner of the Western Balkan countries is the European Union: the share of the EU in total exports of Serbia and Montenegro was 53%, and in exports of Albania 91% (data from 2004), while in the remaining countries the share of the EU varied between these two values. The share of the Western Balkans in the trade turnover of the EU, however, is very small and it represents 0.5% in total trade turnover and 1.3% in the turnover with third countries. All the Balkan states, similarly as the recent EU entrants Bulgaria and Romania, show high deficit in trade with the EU. The largest destination country of exports of all of the states of the Western Balkans was Italy, followed by Germany, Greece, Austria and Hungary.[33]

The largest part of imports of the Balkan states from the EU is received by Croatia – 51.5% in 2003 and 50.6% in 2006. The second place is occupied by Serbia and Montenegro, whereby their share has grown from 22.7% in 2003 to 26.1% in 2006 (including Serbia 22.9%, Montenegro 2.1%). The share of Macedonia and Albania has basically remained unchanged and was at the level of approximately 6%. The share of Bosnia and Herzegovina, in turn, fell from 12.7% in 2003 to 11% in 2006.

The first place in exports from the Balkan countries to the EU is also occupied by Croatia, but its share has decreased between 2003 and 2006 from 49% to 43.5%. On the other hand, the share of Serbia and Montenegro has increased significantly from 22.3% to 27%, and to a small degree the same applies to the share of Bosnia and Herzegovina. The data concerning the geographic structure of trade of the Western Balkan countries are shown in Tables 5.10, 5.11, 5.12 and in Charts 5.12–5.13.

Table 5.10. Geographic structure of imports of Western Balkan Countries from the EU in 2003-2006 (%)

	2003	2004	2005	2006
Albania	6.5	6.3	6.4	6.0
Bosnia and Herzegovina	12.7	12.0	13.1	11.0
Serbia and Montenegro	22.7	25.2	24.1	26.1[a]
Croatia	51.5	50.1	50.0	50.6
Macedonia	6.7	6.4	6.5	6.3

[a] accordingly:22.9 - Serbia, 2.1 – Montenegro, 1.1 - Kosovo
Source: Compiled by the Author based on Eurostat data.

[33] Western Balkans in Transition, Directorate General for Economic and Financial Affairs , No 37, Dec. 2006.

Table 5.11. Geographic structure of exports from Western Balkan Countries to the EU in 2003-2006 (%)

	2003	2004	2005	2006
Albania	5.5	5.1	5.2	4.4
Bosnia and Herzegovina	12.9	12.9	15.3	14.7
Serbia and Montenegro	22.3	22.2	24.4	27.0[a]
Croatia	49.0	49.8	44.0	43.5
Macedonia	10.4	10.1	11.1	10.4

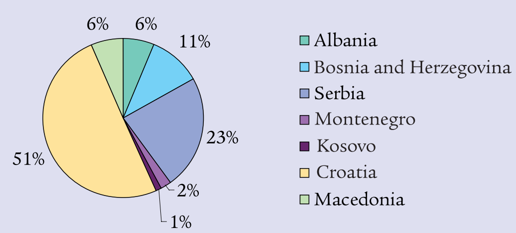
[a] accordingly: 24.3 - Serbia, 2.6 - Montenegro, 0.1 - Kosovo
Source: Compiled by the Author based on Eurostat data.

Table 5.12. Trade between Balkan states and the EU in 2006, EUR millions.

	Imports	Exports	Balance
Albania	1435	493	–942
Bosnia and Herzegovina	2638	1648	–990
Serbia	5488	2691	–2797
Montenegro	518	292	–226
Kosovo	279	27	–252
Croatia	12051	4762	–7289
Macedonia	1524	1152	–372

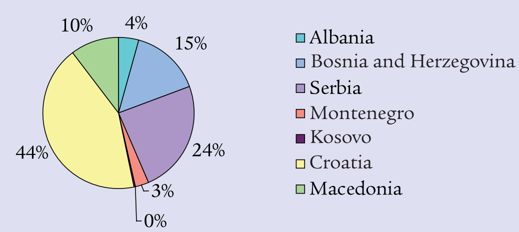
Source : Compiled by the Author based on Eurostat data.

Chart 5.12. Geographic structure of imports from the EU by Balkan states in 2006



Source: Compiled by the Author based on Eurostat data.

Chart 5.13. Geographic structure of exports to the EU by Balkan states in 2006



Source: Compiled by the Author based on Eurostat data.

The rate of growth of trade of the Western Balkan countries with the EU continues to be high and it is the effect both of the progressing liberalisation of trade, political stabilisation and the conducted structural reforms, increasing the attractiveness of the different countries for foreign investors. The commodity structure of exports and imports of the Balkan countries is very similar to the structure of exports and imports of the 12 new members states of the EU. On the exports side it is the category of "other processed goods" with large raw material content that predominates, whereas the side of imports is dominated by investment goods. Serbia and Montenegro are a certain exception, as net exporters of food, as well as Bosnia, as a net exporter of raw materials.

Box 5.4. Foreign trade of Montenegro

The attainment of independence by Montenegro on 2 June 2006 implies the necessity of corresponding adjustment of statistical data, as until 3 June 2006 data concerning Montenegro were provided jointly with the data on Serbia.

Montenegro belongs to one of the smallest states of the Western Balkans with a large share of foreign trade in the economy – the contribution of exports to GDP is 26.5 %, and imports 57.3%. Montenegro has a very high deficit in foreign trade – it represents 30.8% of the GDP.

The structure of exports by commodities is dominated by processed goods, which contribute to 56% of total exports. Montenegro also exports food, condiments and tobacco, as well as being a significant provider of tourist services. The destination receiving the largest part of exports from Montenegro is Serbia (36.8 % of total exports). The share of the European Union in the exports from Montenegro reaches 45 %, and the main partners there are Italy and Greece. On the imports side, the share of EU countries amounts to 40.3%. The achievement of independence should not affect the institutional arrangements in the foreign trade of Montenegro, as within the union with Serbia Montenegro conducted an independent trade policy.[34]

5.7.4. Progress of particular Balkan states in negotiations with the EU

Croatia

Progress has been achieved in the adaptation of national laws to EU law and in implementing the conditions of the Stabilisation and Association Agreement. In 2007 further acceleration of political and economic reforms ought to take place, and especially the reform of the judicial system and public administration. Further changes are necessary in the area of public aid and the property market. Strengthening of regional cooperation and greater focus on problems of national minorities remain as priorities. The progress of negotiations to date is assessed positively,

[34] Western Balkans in Transition, Directorate for Economic and Financial Affairs, No 37, Dec. 2006, p.53.

equally positive are the expectations concerning their future course.

Macedonia

Macedonia has obtained the status of an EU candidate country in December 2005. This decision gave rise to a favourable climate for further reforms, bringing Macedonia closer to integration with the EU. Due to general elections, the pace of reforms weakened somewhat in 2006. The European Commission lists the reforms of the police, the courts, the system of combating corruption, as especially urgent tasks for that country. It is also necessary to continue the implementation of the Stabilisation and Association Agreement.

Albania

Albania has signed the Stabilisation and Association Agreement (SAA) on 12 June 2006. It constitutes a significant element of Albania's preparations for EU membership. Presently, the process of implementation of the provisions of the Association Agreement has began, including the clauses concerning trade, contained in the interim agreement, which is in force from 1 December 2006. Over the period 2005-2006 Albania has noted progress in many key areas, including especially the domain of combating corruption and organised crime, as well as that of creating the institutional conditions for the implementation of the Association Agreement. Nevertheless, it is still necessary to strengthen the administration and to introduce certain changes in the structure of ministries. Further progress in the conducted reforms depends, above all, on the quality of cooperation between the government and the opposition, which has a bearing upon the pace of reform of the political system, including especially the system of justice and respect for human rights and freedom of the press.

In the area of fulfilment of economic criteria for EU membership, Albania has attained the status of a country with a market economy. The Report of the European Commission points at the increasing stability of the economy, strong economic growth combined with the accompanying low inflation and the reduction of barriers to the freedom of market exchange. It is necessary to further enhance the competitiveness of the Albanian economy, as low competitiveness of its business enterprises is the cause behind a high deficit in foreign trade. Albania should improve the conditions for investment at a much faster pace than it was the case until now, including upgrading the infrastructure, and constrain the excessively large informal sector of the economy. Regulations concerning public procurement and protection of intellectual property rights, as well as veterinary and phyto-sanitary inspection, are of particular importance for the growth of investment. The government of Albania should accelerate the process of adaptation of such regulations to the rules prevailing in the EU.

Bosnia and Herzegovina

The negotiations of Bosnia and Herzegovina concerning the signing of the Stabilisation and Association Agreement began in November 2005. Their conclusion depends, above all, on progress in cooperation with the International Tribunal for War Crimes in former Yugoslavia, reform of the police and legislation regulating the operation of radio and television. Good results have been achieved with regards to political stabilisation and security, as demonstrated by the decision to gradually phase down the activities of the Office of the High Representative and the Special Representative of the EU. Both offices oversee the implementation of the provisions of the Dayton Agreement, their mandate has been prolonged until the end of June 2008. The results of the elections of October 2006 have demonstrated that in both countries gradual consolidation of the system of democracy and the rule of law is taking place. Effects in this domain will be reinforced by the currently initiated reform of public administration. In the economy some progress has been achieved on the way toward the recognition of Bosnia and Herzegovina as a country with a market economy. The coordination of fiscal policy has improved, the VAT tax has been introduced on the territory of the whole country. Nevertheless, economic growth is still being hampered by the large imbalance in foreign trade and on current account. It is necessary to speed up the process of privatisation and restructuring of business enterprises.

The process of adaptation of national law to EU rules is being continued, progress has been noted in the area of tax law, competition policy, regulations concerning the transport and energy sectors, and also in the areas of justice and home affairs. Provisions of the laws concerning trade, customs, public aid, employment, education and protection of the natural environment are awaiting for the enactment of amendments. These delays have brought the European Commission to assess the progress in reforming the economy done in the year 2006 as unsatisfactory.

Montenegro

Montenegro gained independence as a result of the referendum of June 2006. Negotiations concerning the Stabilisation and Association Agreement with the EU started on 26 September 2006. They are a continuation of earlier negotiations conducted with Serbia and Montenegro. Parliamentary elections in Montenegro were conducted in accordance with all respective international standards. Further improvement is necessary with regards to the operation of the government, parliament and public administration. The efforts made toward combating corruption and organised crime should be seen as a positive phenomenon, although the work of the courts and state institutions is still not effective enough. The Constitution of Montenegro should also be changed.

Progress has been achieved on the way toward the market economy, the European Commission assesses especially positively the degree of macroeconomic stability, the rate of economic growth and the level of foreign direct investment. Nevertheless, the European Commission is concerned about the big dependence of the economy on the development of just a few sectors and the high balance of payments deficit. The rigidity of the labour market is unfavourable for further development, as it gives rise to high unemployment. Deregulation is necessary not only on the labour market, but also in other areas of the economy. Overregulation of the market is one of the causes of low competitiveness of business enterprises.

Montenegro is introducing changes to the national law, adapting it to the standards of EU law. This process is progressing too slowly, however. In order to speed it up it is necessary to strengthen the institutions responsible for law making and the administration responsible for the implementation of new regulations, progress ought to take place in such areas as: the free flow of goods, customs, competition, public procurement, social policy and employment. Particular attention needs to be given to the enforcement of justice and internal security (combating organised crime, visa policy).

Serbia

Serbia has achieved major progress in the negotiations concerning the Stabilisation and Association Agreement. Nevertheless, the negotiations were interrupted in 2006 due to the lack of cooperation with the International Tribunal for War Crimes in former Yugoslavia on the part of Belgrade. In May 2007 the decision was made to resume these negotiations. The political situation in Serbia is systematically improving. A new Constitution has been adopted, the reform of the administration and of the judicial system has been initiated, a strategy for combating corruption has been devised. The new constitution, however, does not contain regulations protecting the independence of the courts, civilian control over the army needs to be strengthened. In May 2007 a new pro-European parliament and government were elected.

The status of Kosovo province remains unresolved. Presently, the UN are preparing a resolution supported by the EU and USA, foreseeing the granting of independence to Kosovo and adopting a constitution within 90 days, as well as the organisation of parliamentary elections within 9 months.

Major progress has been achieved on the way toward the market economy. Serbia has noted an increase of foreign direct investments, but most of them concern acquisitions of privatised enterprises. The interruption of negotiations concerning the Stabilisation and Association Agreement has led to the decrease of interest on the part of foreign investors in green field projects. According to certain estimates, the decrease of investments on this account amounted to between EUR 1.5 and 2 billion. It is necessary to continue the reforms in the area of public finance and to actively restructure the sector of business enterprises, including the introduction of regulations concerning bankruptcy.

A large part of the national level legal regulations has been adapted to the European law, including provisions on money laundering, human trafficking, the flow of services, education, agricultural policy, social policy and transports. In such areas as: taxation, public aid, protection of the natural environment, protection of intellectual property, consumer protection, information society; the process of adaptation of local law to the community law continues.

Kosovo

The political situation has stabilised, the process of arriving at agreements between Russia and the USA concerning the text of a new UN resolution on Kosovo is in progress. In the field of political reforms, the system of parliamentary work has been changed, the ministry of justice and home affairs has been established. According to the recommendations of the European Commission it is necessary to strengthen the sector of administration and of the judiciary. The conditions regulating the return of refugees are insufficient. In economic policy stress has been laid upon the tightening of fiscal policy and privatisation of state owned enterprises. Progress toward a market economy is unsatisfactory, however, due to the lack of macroeconomic stability: unemployment is high and the degree of enforcement of property rights is low. Also the process of bringing the law and institutional arrangements closer to European standards is progressing too slowly.

5.7.5. EU aid granted to countries of the region of the Western Balkans

From 1 January 2007 the European Commission has introduced a new form of support for reforms in the candidate countries to the EU and in countries that are potential candidates – the *Instrument for Pre–Accession Assistance* (IPA). This new financial instrument replaces all the previous support programmes, such as: SAPARD, ISPA, and the CARDS programme, specially created for the region of the Balkans.

The IPA programme consists of five components, adapted to the needs of the particular countries: the funds for the financing of the process of transformation and institution building, cross-border cooperation, regional development, human resources development and development of rural areas. The consolidation in an integral whole of all the previously applied instruments with a single source of financing in the form of Multi-Annual Indicative Financial Framework seems to be a sensible step. Thanks to this decision the coordination of aid granted by the European Commission ought to improve, and also it should lead to greater transparency and better, more flexible application of the allocated funds. The reform of the system of aid will also contribute to better coordination of aid financed by institutions other than the EU itself, such as the EBRD, EIB and the World Bank. The European Commission intends to develop more effective forms of financial support, combining grants and loans coming from other sources.

Table 5.13. EU pre-accession aid to the Balkan countries in 2007-2009 foreseen in the Multi-Annual Indicative Financial Framework

Pre-accession aid in EUR millions	2007	2008	2009
Croatia	138.5	146.0	151.2
Macedonia	58.5	70.2	81.8
Albania	61.0	70.7	81.2
Bosnia and Herzegovina	62.1	74.8	89.1
Montenegro	31.4	32.6	33.3
Serbia	186.7	190.9	194.8
Kosovo	63.3	64.7	66.1

Source: Europa, Rapid Press Releases, 8.11. 2006.

Table 5.14. Allocation of aid under the CARDS programme in 2000-2006, EUR millions

	2000	2001	2002	2003	2004	2005	2006	Total
	33.4	37.5	44.9	46.5	63.5	44.2	45.5	315.5
Albania	90.3	105.2	72.9	63.0	72.0	49.4	51.0	502.8
Bosnia and Herzegovina	16.8	60.0	59.0	62.0	81.0			278.8
Croatia (do 2005)	13.0	56.2	41.5	43.5	59.0	45.0	40.0	298.2
Macedonia	650.5	385.2	351.6	324.3	307.9	282.5	257.5	2559.6
Serbia and Montenegroa	70.0	120.0	100.0	15.0	16.0	33.0	50.0	404.0
Grants	161.7	138.0	54.5	48.5	38.5	67.6	59.6	575.3
Regional aid and other						105.0	140.0	245.0
Croatia pre-accession 2005-06	1045.7	926.9	756.4	634.8	679.9	662.7	676.6	5385.0

[a] including Kosovo
Source: European Commission, http://ec.europa.eu/enalrgement/financial_assistance/cards/statistics2000-2020

Until the year 2013 the Western Balkan countries (including Turkey) will receive EUR 11.5 billion from the new programme. Tables 5.13 and 5.14 contain data concerning the magnitude of aid for the countries of the Western Balkans in the framework of the hitherto existing structure of the CARDS programme and the anticipated aid inflows in the new structure of the Multi-Annual Financial Framework. Owing to the introduced reform of the aid granted, data for the period 2000-2006 and 2007-2009 are not fully comparable.

It seems that the certain imprecision of measurement should not affect the picture of the geographic structure of aid granted to the different countries. Serbia, both presently and in the years 2007-2009, is the largest beneficiary of European funds. It is worth noting, however, the substantial growth of the share gained by Croatia, which is a consequence of its increasingly advanced process of negotiations with the EU.

It is worth reminding that in the period 2001-2005 large differences between the levels of EU aid in per capita terms were visible. For the countries having the candidate status this indicator was at the level of EUR 139 (2005), whereas for the other countries it amounted to EUR 106 (2005) and increased at a much slower pace.[35] These differences are a consequence of two factors: preferences in EU policy addressing the countries achieving greater progress in the implementation of political and economic reforms, as well as higher absorption of the allocated funds resulting from the effects of structural reforms.

Comparison of the magnitude of aid granted under the CARDS programme (2000-2006) and the anticipated scale of support in the years 2007-2009, and also the data contained in the EU budget for 2007-2014, indicates the maintenance of the hitherto existing moderate rate of growth of the support funds in successive years. This may

[35] EU-WB Joint Office for South East Europe (June 2005), Development Researches Network Study on the Linkages between the Economic development of the Countries of the Western Balkans and Progress in the Institutional Reform Process. Final report, Rome/Brussels, July 2005, p.20.

Table 5.15. Structure of EU aid for the Western Balkan countries by sectors in 2002-2004, EUR millions

Sector	Albania	Bosnia and Herzeg.	Croatia	Macedonia	Serbia	Montenegro	Kosovo
Judiciary and home affairs	75.0	58.0	43.85	43.5			
Strengthening of the administration	17.0	44.0	38.90	31.5			
Economic and social development	42.4	29.9	53.25	37.5			
Protection of the environment	11.0	18.0	10.50	3.0			
Civil Society					54.5	4.5	18.8
Stabilisation of democracy	4.5	50.0	50.50	9.0			
Economic reconstruction					395.5	21.5	178.2
Institution building					157.5	17.0	51.2

Source: Prepared by the Author based on data from: the European Commission, http://ec.europa.eu/enalrgement/financial_assistance/cards/statistics2000-2020

imply the necessity to reduce the scale of the introduced reforms and prolongation of the period of their implementation.

In all the countries of the Western Balkans the EU aid funds were destined, above all, for the financing of so called soft projects, supporting the institutional reforms (Table 5.15). The differentiation of the objectives, for the implementation of which the EU funds were granted is visible, as this differentiation corresponds to the structure of the challenges indicated by the European Commission in the reports monitoring the preparation for accession. In Albania, Bosnia and Herzegovina, Macedonia and Croatia, most of the funds were used for the improvement of the judiciary and internal security, as well as strengthening of the administration and stabilisation of the democratic system. In the case of Serbia, Montenegro and Kosovo, in turn, the priority consisted of the reconstruction of the economy and creation of institutions preparing these countries for EU membership. In accordance with the EU strategy of preference for the strengthening of central institutions, most of the resources of the CARDS Programme were destined for the ministries, including especially the ministries of the interior and the judiciary systems. Local administration participated in the aid programmes to a much lesser degree.

5.7.5. The future of the cooperation of the Western Balkan states with the EU and their accession prospects

In the years 2006-2007 increasing scepticism concerning the possibility of prompt indication of the date of EU accession of the Western Balkan countries is perceptible. The new enlargement strategy, published in 2006, contains elements, which give reasons to presume that in the course of the next few years the European Commission will be delaying any decision concerning the admission of new members.

Moreover, it seems that the decision on EU enlargement will be dependent to a much greater extent than before on the progress of political reforms. The quality of political reforms in the new member states and in the candidate countries to the EU is one of the reasons behind the low acceptance of any next enlargement. A certain obstacle consists also of the differences in the degree of advancement of the preparations of different countries to EU membership, while the scale of such differences over the next few years will probably not change.

Two new elements have been introduced to the cooperation of the Western Balkan countries with the EU: reform of the existing system of granting pre-accession aid and the strengthening of intra-regional cooperation in the framework of the enlarged CEFTA grouping. The first element should bring benefits in the form of better coordination of aid and its greater effectiveness, the second one, in turn, ought to speed up regional integration, by indirectly influencing the pace of the necessary structural reforms in the region.

It is worth noting, however, that most of the Western Balkan states were highly sceptical with regards to the idea of creation of a free trade zone, in the fear that such an institution would slow down, rather than accelerate, the pace of their integration with the EU. The issue of the small scale of the market covered by such a zone was also raised. A small market constitutes a barrier to the development of trade within the region, limiting therewith the impact of trade liberalisation upon the rate of economic growth in the region. A much greater effect can be generated by the initiated joint ventures in the area of infrastructure and energy, owing to their impact upon the investment attractiveness of the region.

In the document of the European Commission concerning the strategy of enlargement for the years 2006-2007 three basic principles of EU enlargement policy were formulated: consolidation of commitments, conditionality, and the tactics of communicating with the citizens of the member states and candidate countries.[36] The first one implies prudence in formulating

[36] Communication from the Commission to the European Parliament and the Council. Enlargement Strategy and Main Challenges 2006-2007, COM(2006) 649, Brussels, 8.11.2006., p.5.

future commitments and honouring those, which have already been assumed. The principle of conditionality consists of the requirement to realize all the conditions put forward in the course of successive stages of negotiation of prerequisites for membership. Finally, the third principle has to do with the need to obtain the acceptance of EU membership by the communities of both the candidate countries and the member states of the EU. Hence the requirement to conduct an effective information campaign and assure dialogue of the governments with the citizens.

Based on the principles indicated above, the process of preparation of the EU for the next enlargement phase continues. One of its significant elements consists of making use of the experiences gathered in connection with the gaining of membership by Bulgaria and Romania. These experiences indicate to countries only just starting the negotiations that the objective consisting of bringing the negotiations to conclusion is feasible, and make it easier for the European Commission to introduce certain modifications to the procedures regulating the enlargement process.

One such modification consists of the application of the principle of possibly early start of reforms of the judiciary, which is important in combating corruption and organised crime. The introduction of changes in these areas requires a much longer period of time, however, than what had been originally assumed. It is equally important to maintain the continuity and the appropriate pace in reforming the public administration, owing to its role in the process of preparation for membership.

Some experts point out that for the first time in an official EU document different formulations than before have been used to express the intentions concerning its future enlargement.[37] These changes are subtle, yet rather clear. All the three above described principles of the new strategy may be interpreted as symptoms of *enlargement fatigue* on the part of EU member states and of their growing concerns with regards to prospects of EU entry of the Western Balkan countries. Hence the clear striving to maintain and strengthen the controls over the course of preparations of new states for EU membership.

The enlargement fatigue and doubts concerning the possibilities of absorption by the Union of countries that are at a lower stage of development emerged already in the year 2004, after the first wave of enlargement, and they grew further before the adoption of the final decision on the accession of Bulgaria and Romania. According to members of the International Commission on the Balkans, some of the causes behind this situation are embedded in the value system prevailing among the citizens of the so called old Union, and are not of economic nature.[38]

This implies that the next enlargement process will be a much more difficult challenge than the accession of 10 new members in 2004, as well as Bulgaria and Romania in 2007, so owing to this fact the process of preparing the EU accession of the Western Balkans will take longer than the process of accession of the countries of Central and Eastern Europe.

The anticipated date for the obtaining of membership indicated in the report of the International Commission on the Balkans (2014-2015)[39] is not a timeline recognised by the European Commission. According to the European Commission, the setting of any date will be possible only after conclusion of the negotiations. The experience of Poland and other new EU member states indicates, however, that the lack of such a date makes the process of adaptation to membership more difficult, as it does not sufficiently discipline the administration and does not generate enough pressure for the efficient implementation of the necessary reforms.

Some experts describe the present strategy of the European Commission concerning the Western Balkans as an attempt to stop half way between backing out from existing commitments and prompt integration. This kind of strategy of "suspending" the enlargement process results in the lack of motivation on the part of the EU to set the date for the next enlargement and is a bad prognosis for the pace of further changes in the region.[40]

A significant factor behind the weakening of political will toward further enlargement consists of the unresolved internal problems within the Union. The dragging process of adoption of the Constitutional Treaty constrains the efficiency of the Community institutions, there is a lack of essential progress in the implementation of the Lisbon Strategy, and in the outside world, apart from the United States, new centres of fast growth such as China and India have emerged, making the goal of achievement by Europe of the position of the most competitive economy of the world increasingly hard to reach.

[37] Adele Brown and Michael Attenborough "EU Enlargement: the Western Balkans", House of Commons Library, Research Paper 07/2007, p.19.

[38] Statement from the International Commission on the Balkans, 9 May 2006.

[39] *The Balkans in Europe's Future*, 2005.

[40] "East European Politics and Societies", 2006.

Table 5.16. List of projects financed jointly by the EBRD and the EU

Country	Project	Sector	EUR millions
Albania	Albania Telekom	Telecommunications	1.7
Bosnia and Herzegovina	Rebuilding of transport networks	Transport	14.4
	Rebuilding of power plants	Energy	14.0
	Bank “ProCredit Bank Bosnia”	Financial institutions	10.9
	Rebuilding of telecommunication networks	Telecommunications	6.5
Serbia and Montenegro	Rebuilding of power plants	Energy	8.7
Total			56.2

Source: EBRD-EU Cooperation in the Western Balkans: Cooperation and trade exchange in the Western Balkans region.

5.7.6. Support to the Western Balkan countries given by the EBRD in the framework of the Process of Stabilisation and Association with the EU

The European Bank for Reconstruction and Development (EBRD) cooperates closely with the EU in the process of implementation of the programme of reforms in the region. EBRD resources are used, above all, to support investment projects in the private sector and in the sector of public services. The financing of investments takes place through the *Technical Cooperation Funds Programme*. Starting from 1992, approximately EUR 83 million have been used to finance 400 contracts for consultants, as a result of which investments worth EUR 1.5 billion were made.[41] The list of the most important projects comprises investments in the energy sector, telecommunications and transport (Table 5.16). A part of the funds is also earmarked for projects that finance the development of private sector banks and increase their capacity to grant loans to business enterprises and local self-government authorities.

[41] EBRD - EU Cooperation in the Western Balkans, ...