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**Research Report**

## Elements of a Romanian strategy in the post-enlargement EU

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**Study no. 7**

**ELEMENTS OF A ROMANIAN STRATEGY  
IN THE POST-ENLARGEMENT EU**

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## **Introduction: The strategic perspective on the future of European integration**

Romania passed the first century of its modern evolution (1848-1989) navigating between democratic experiments and dictatorship, of left or right ideology. After a brief interlude of ideological clarifications, the country prepares anew to step into a radically different context of its historical evolution. This time the pledge involves official and formal trans-national commitments: by negotiating and signing in 2005 the *Treaty of Accession* to the European Union (EU) the Romanian officials committed the country to adhere to political principles and economic norms which are decided by a socially and culturally heterogeneous group of 27 countries, mostly advanced democracies. The change looks radical as the future shape of developments affecting daily life of Romanians is programmatically transferred to an at times arcane decision-making process carried out in varying degrees both inside and outside Romania.

This study attempts to outline the strategic perspective on next decade's expectations related to Romania's evolution in the process of European integration. It hardly is the only necessary approach as to the post-enlargement phase. A technical point of view (Is Romania capable to mobilise the required resources in order *to comply with* the *acquis* requirements?) or a political angle (What place can the Romania thinking find within *the European ideology*?) may be taken with equal interest to justly weigh the country's future position in an enlarged Europe. Instead, this paper rests on the assumption that the EU embodies a future centre of governance which has already reached the level of a *complex organisation* in the sense the literature ascribes to complex situations, namely that where an "increasing number of independent variables are interacting in interdependent and unpredictable ways."<sup>1</sup> There are two complementary perspectives to approach the future state of complex systems: a deterministic analysis based on quantitative scenarios and a non-deterministic inquiry based on hermeneutical insights. Both ways describe alternative futures against which strategic decisions can be explored.

The quantitative-based method explores real situations and finds variables which can approximate as completely as possible future scenarios. The European integration model inspired remarkably consistent such predictions prescribed by a computable general equilibrium (CGE) model for the world economy, World Scan.<sup>2</sup>

Two groups of "key uncertainties" are assumed by the model: international cooperation – to what extent are nation states willing and able to cooperate within international organisations like the World Trade Organisation and the European Union?; and national institutions – to what extent will the mix of public and private responsibilities change? Combining these two key uncertainties leads to four different scenarios as shown in **Table 1** below.

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<sup>1</sup> Quotation from Sanders and McCabe, p. 8.

<sup>2</sup> Reference is made to the studies of De Mooij, R.A., and P.J.G. Tang, *Four Futures of Europe*, The Hague: Sdu Publishers, 2003 and Lejour, Arjan, "Quantifying Four Scenarios for Europe", CPB Document, No. 38, October 2003.

**Table 1: Scenarios of European integration in the World Scan model (CBP)**

<i>Scenarios</i>	<i>Assumptions about uncertainties</i>	<i>Alternative futures</i>
<b>I</b> Strong Europe	International cooperation and Public responsibilities	The process of EU decision-making is reformed. The enlargement is a success and integration proceeds further, both geographically, economically and politically. Europe is the driving force behind broad international cooperation – not only in the area of trade, but also in other areas such as climate change and poverty reduction. European countries maintain social cohesion through public institutions. The governments undertake selective reforms in the labour market, social security and public production. This policy helps to maintain a stable and growing economy.
<b>II</b> Regional Communities	National sovereignty and Public responsibilities	The European Union cannot adequately cope with the Eastern enlargement and fails to reform her institutions. As an alternative, a core of rich European countries emerges. More generally, the world is fragmented into a number of trade blocks, and multilateral cooperation is modest. Governments are unsuccessful in modernizing welfare-state arrangements. A strong lobby of vested interests blocks reforms in various areas. Together with an expanding public sector, this development puts a severe strain on European economies.
<b>III</b> Transatlantic Market	National sovereignty and Private responsibilities	Countries are reluctant to give up their sovereignty. Reforms of EU decision making fail. Instead, the European Union redirects her attention to the United States; they agree upon transatlantic economic integration. Following social preferences for individual freedom and diversity, European countries limit the role of the state and rely more on market exchange. New markets (e.g. for education and social insurance) lack transparency and competition. The elderly dominate political markets and oppose comprehensive reforms of the pay-as-you-go systems in continental Europe.
<b>IV</b> Global Economy	International cooperation and Private responsibilities	Economic integration is broad and global. The new WTO round succeeds and economic integration in an enlarging European Union intensifies. The problem of climate change intensifies. National institutions become increasingly based on private initiatives and market-based solutions. European governments concentrate on their core tasks, such as the provision of pure public goods and the protection of property rights. They engage less in income redistribution and public insurance. Incomes become more unequal, but grow relatively fast on average.

Source: Lejour, "Quantifying..."; DeMooij and Tang, *Four Futures...*, pp. 21-22.

There are two comments worth mentioning about that sort of prognosis. First, it offers the evident advantage of having *basic macroeconomic estimates*, which prove so helpful in economic and budgetary planning on the long term. A country positions itself within the group it belongs to according to its choice as to the foreseeable average indicators. The output of scenarios parallels the tenets of economic theory in great detail: the "Global economy" scenario, which reproduces both the economic and institutional liberalism of orthodox theories, generates the best results during the period up to 2040 as regards the gross domestic product (GDP), GDP per capita growth, employment, and world exports of the EU area.

It is however a plausible supposition that a scenario's projection becomes confused or even misaligned and this prompts a second commentary: some events are merely left out by the modelling process, while others make the scenarios' boundary a useless distinction. It is, for instance, greatly conceivable to meet the influence of the interest groups, so visible in II, at the same level of intensity in any other representation. Motivations of crucial EU decisions like Stability and Growth Pact, Single Economic Area or Common Agricultural Policy were

largely political, rooted in a negotiating context largely based on *quid pro quo*<sup>3</sup>. Likewise, military conflicts or justice issues do not play any role in that scenario building, nor do they mention China's economic and political increasing clout in world affairs. When the EU set the new strategic goal for the next decade in March 2000 in Lisbon to become "the most competitive and dynamic knowledge-based economy in the world" it did not mention China or the current oil problems among the challenges ahead, issues which presently dominate any political agenda of the EU officials.

The common wisdom which surfaces from frequent polls<sup>4</sup> speaks of an integration process which is considerably more versatile than the deterministic approach would allow. The integration is mainly built on internal coordinates – the European Constitution, possible further enlargements and the single currency – within a fragile social and political context. Half a century since its inception, the Community finds its citizens equally split between those who have (44%) and those who have not (43%) confidence in the EU. Their immediate concerns are attached to every day standard of living and go significantly beyond future abstract projections: among the EU priorities, their first choice is combating unemployment (47%), followed by the fight against poverty and social exclusion (44%), at appreciable distance from the next ranked aspiration of a European Union that is closer to its citizen (19%).

It is this sort of strategic challenges which is given prominence in the present study. By identifying the critical components of the EU integration process, one may get a better position to understand the determinants of power and this is what motivates the main research objective: introduction to the strategic thinking on the European integration edifice. The European Union has evolved through gradual increases in the range of coordination and in the centralization of power, which bring into view unforeseen evolutions of economic policies, foreign and military initiatives, sharing of political power or intra-European conflicts. As a consequence, this research makes up a complementary part to macroeconomic prognoses by providing elements of strategic perspective for Romania on institutional, economical and financial grounds to (1) meet the requirements of an EU Member State with a view to (2) promoting its interests and to (3) favourably confronting the EU visionary initiatives and to (4) distinguishing from this perspective the present priorities.

To prescribe the elements of a strategy on these four coordinates, this research incorporates the relevant literature suggestions<sup>5</sup> and accordingly makes a first step to consider the issue a *knowledge problem* and an *interest and power problem*. What is left refers to the proper body of a strategic policy just sketched in this material, with its necessary connections to the formulation, implementation and evaluation of the proposed strategic recommendations.

The European integrating assembly constitutes by itself an example of complex progression. The EU is an umbrella organization that comprises three parts, or "three pillars". The Treaty of Rome (1957) consolidated the first pillar of the European Communities (EC). At the heart of this pillar are the "four freedoms of movement": of persons, goods, capital, and services, plus single market and competition issues. This pillar also covers a number of other issues, including agriculture, competition, and trade, and recently also visa and asylum policies. The other two pillars are part of the EU, but not of the EC, and are grounded in the provisions of the Treaty of Maastricht (1993) and the Treaty of Amsterdam (1999). They

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<sup>3</sup> According to the evidence put forth by Feldstein; Moravcsik; Alesina and Perotti.

<sup>4</sup> TNS Opinion & Social, *Eurobarometer 63*, pp. 30, 104, 120.

<sup>5</sup> DeTombe, "A New Methodology "

formalize the principle of subsidiarity, which asserts that activities will be assigned to the most appropriate level of government, European, national or local. The second pillar includes the Common Security and Foreign Policy (CSFP). The third pillar, Justice and Home Affairs, now includes mostly police and judicial cooperation in criminal matters. The Nice Treaty (2001) prepared the institutional EU for further enlargements and made changes to the number of commissioners, the number of members of the Parliament and the decision weights in the European Council.

Against this evolving institutional background, the methodological issues of knowledge and interest representation suggest three levels of strategic focus. The first refers to the way decisions are divided between the EU and its Member countries. The EU is not a federal organisation; it is rather recognised as a *sui generis* institutional structure<sup>6</sup>, which allows its member countries to act internationally as legal persons, while the competency division between the Union and its members results from joint responsibility. What gives this institutional fluid a stable nature, so that Romania acting in its capacity of member country be able to found an advantageous arrangement for interest representation?

A second level of strategic focus is the subject of the EU policies radiating in several particular directions, which become distinctive as a result of their highly characteristic dual decisional procedure – national and supra-national – of considerable influence at the horizon of 2010-2015. Among the possible choices, this study considers the monetary, competitiveness, fiscal, and security and defence domains. What kind of solutions are envisaged and what are the means at members countries' disposal, in general, and Romania's, in particular, to outline the foreseeable trends in conformity with the national objectives make up the main investigation theme in this section.

Finally, the third level of strategic focus results from the implications pertaining to the integration mechanism of Romania. Interest representation and specific knowledge of the most influential policies set the stage to draw up a sketch of the first elements for a post-enlargement strategy. What considerations should Romania base on its capability to adapt and influence, as generic objectives of any strategy? What are the required abilities to make the strategic intervention an effective one? Several possible answers are gathered to compose an agenda for post-enlargement strategic policies.

The educated opinion in Romania is predominantly represented by those who see the Economic and Monetary Union as a Community attribute, Pillars II and III of mainly national influence, and the political union a space of integration subject to inter-governmentally negotiations<sup>7</sup>. This study's conclusions with regard to the impact of each strategic focus show that the post-enlargement preparedness should necessarily be placed beyond that comfortable and seemingly predictable perspective on membership. The European construction represents a complex structure and this is a fact which combines by its very nature the transparency of an institutional representation made necessary by the current policy administration with the interdependency and unpredictability of ongoing processes and events.

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<sup>6</sup> Cosmovici, "Uniunea Europeană în labirintul viitorului...", pp. 30, 43.

<sup>7</sup> Idem, pp. 22, 36.

## **I Strategic focus #1: Interest representation**

On the course of the Community policy-making – from policy initiation (or agenda-setting) to decision making and to implementation – interest representation at the supra-national level predominantly is a characteristic issue of the first two stages. Although the provisions of the Treaties<sup>8</sup> founding the EU rule out any prescription for the policy implementation phase except for either conformity with *acquis communautaire*, or national measures based on the principle of subsidiarity, the history of European integration shows that sufficiently well represented interests of national concern may suffice to disobey a Community decision<sup>9</sup>. According to the same texts, it is the Court of Justice (CJ) which is entitled to issue *Judgments* and *Opinions* in order to make the defendant submissive to the Community decision, but the governmental influential role should actually be perceived as part of the general EU power game as long as the enforcement of the Court's decisions "shall be governed by the rules of civil procedure in force in the State in the territory of which it is carried out." (Art. 256, *Treaty Establishing the European Community*)

The case of deliberately ignoring the EU norms is not, as it seems, so uncommon as the Community functioning imposes, but it certainly is unlawful and against the spirit of this integrating mechanism, what leaves it beyond the scope of the present subject due to its wider range of implications. A different instance however results from initiation and decision with respect to Community policies, which by their very legal construct do not come into being without interference of national opinions. A Member country could hardly dismiss the consequences: Brussels has turned into an important centre of decision-making power as between 50% and 80 % of all legislative acts in force within member states are community law<sup>10</sup>. What is however more relevant to this study, against estimates showing that approximately 80% of a policy is set before it reaches the decisional phase proper<sup>11</sup>, then determining which actors help shape policies as they are eventually formulated is an important key to explaining the EU policy making. Consequently, *who how what* decides represents the first topic of strategic focus.

In spite of supposedly unambiguous legal formulations, the process of decision-making may seem "secretive and bewildering"<sup>12</sup>, "problematic"<sup>13</sup>, "cloaked in secrecy"<sup>14</sup>, "complex" and opaque<sup>15</sup>. Some authors even doubt that somebody informed could "grasp the degree of effective presence of EU institutions in the relevant areas of policy-making."<sup>16</sup> Confusion seems to be the best explanatory word; a study on the EU decision-making process uses in association the word seven times<sup>17</sup>, but finds room to mention "benefits" just once, while "gains", for instance, receives no mention. The landscape of Community decision gets

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<sup>8</sup> References in this study to these texts are made to: *Treaty Establishing...* and *Treaty of Nice*.

<sup>9</sup> Evidence is put forth by Philip

<sup>10</sup> Lehmann, Wilhelm, "Lobbying ...", p. 2; Meerts and Cede, *Negotiating European Union*, p. 11.

<sup>11</sup> Cloutier; Another study is more specific: 85 percent of all dossiers are settled before they reach the ministerial level – 70 percent in Council working groups and another 15 percent in the next stage of negotiations between permanent national representatives (qt. by van Keulen, Mendeltje, "What Happens at Home – Negotiating EU Policy at the Domestic Level" in Meerts and Cede, pp. 35-50).

<sup>12</sup> Philip, p.14

<sup>13</sup> Bausili

<sup>14</sup> Heisenberg, Dorothee, "What Kind of Negotiation 'Consensus Decision Making' Involve?" in Meerts and Cede, pp. 93-110.

<sup>15</sup> DeMooij and Tang, p. 16.

<sup>16</sup> Alesina et al., "What Does the European Union Do?", p. 4.

<sup>17</sup> Alesina and Perotti, "The European Union..."

obscured not only by the ever more complex (still "professionalized") reality of organizing and representing interests (*who how what decides*); the issue of strategic interactions among the member countries equally raises several choice options. The governmental posture within the decisional domain in Brussels varies among the member countries depending on different development models, cultural traditions or regional interests. It probably is this latter context where the case of strategic intervention at the national level is mostly visible.

## **I 1 The strategic context of Romania's interest representation**

An enlarged Europe will create a context for option formulation in which Romania is about to find the integration issue significantly distinct in comparison with the accommodation to the *acquis* requirements specific to the accession negotiations; although it is not appropriate to demean the latter type of problems, now it is about an ever increased level of interdependencies among the member countries, which demands a different strategic behaviour. The steering of the decisional mechanism is mainly routed by two coordinates: positioning to the immediate challenges of integration and belonging to certain interest groups. These two directions complement the inevitable recourse to the Community policy-making in force with the independence and the interdependence of strategic interactions, respectively, and are thus together the main sources of national preference ordering in taking part in the decision process<sup>18</sup>.

The first level of preference ordering confronts the EU membership position and, by implication, external options and constraints for development. Less than a decade of approaching the market economy and simultaneous negotiation of accession finds itself condensed in a contrasting image which gets together both unlimited support and lack of preparedness for integration. Among the member and candidate countries, Romania has become known<sup>19</sup> for the highest level of support for a European political Union, where 77% of the population are in favour of the concept against 55% in EU-25, as well as the strongest supporter (62%) of further enlargement of the European Union to include all countries wanting to join. The business community is a highly visible player in this general euphoria: against the average tendency where almost two thirds of the respondents (59%) are optimistic or very optimistic about their business prospect, Romania's share reaches the highest limit (78%)<sup>20</sup>.

Against this seemingly unreserved enthusiasm, there are in fact few indications to suggest a sufficiently stable control of the integration course. The society hardly is prepared to embrace the principles of the new administration, from the state's constitutional grounds<sup>21</sup>

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<sup>18</sup> In broad lines, focus #1 hypothesizes on considering the strategic behaviour on preference ordering dependent on three levels of interactions: dependence (on the Community mechanism), independence (stemming from the domestic sources of interest representation), and interdependence (based on direct confrontation of issue-specific interests). A theoretical exposition is provided by Cojanu, *The Integration Game*.

<sup>19</sup> *Eurobarometer 63*, pp. 122, 158.

<sup>20</sup> Eurochambres and SBRA, p. 26. The survey concerned the then 10 acceding countries: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.

<sup>21</sup> A working group was founded in December 2000 and assigned to study the conformity between the constitutional provisions and the *acquis communautaire*. In its first two years of functioning, it did not produce any public document (Cornescu et al., p. 45.) Shortly after, in December 2003, a revised version of the *Constitution* is adopted and validated through referendum at margin due to a low poll turnout.

to those of Community policies<sup>22</sup>. The signing of the Treaty of Accession took Romanian companies unawares of the challenges ahead: with only 4% of them fully informed on the *acquis* (a decrease compared to 7% in 2003), they exhibit the lowest share among the ten countries, whereas more than half the companies did not start organised preparations yet which again ranks Romania last among the surveyed population<sup>23</sup>.

In one of the rare attempts to configure Romania's future position in Europe, a study<sup>24</sup> lays the domestic aspirations with respect to integration on a coherent conceptual framework but with no noticeable results. This finding adds to a recurrent line of investigation which similarly emphasized a lack of argumentative debates on major themes of market and development<sup>25</sup> along with the exclusive concern to take on the *acquis* requisites<sup>26</sup>. At the same time, the EU attention attached to developmental options or, to put it differently, to options between the ideology's idealism and the social needs' realism has come to the top of Community priorities. In spite of a *Declaration on the Future of the Union* annexed to the Treaty of Nice, a *Convention on the Future of Europe* which was accordingly established, and the *Constitutional Treaty* which was subsequently elaborated and submitted to the ratification process, the EU is marked by a burdensome dilemma between a social and a liberal Europe. Key themes related to the importance of competitiveness, of being innovative, of keeping up with the main competitors in a globalising world received conditional support to the summit of chiefs of state and government in November 2005 to the need to modernise the European social model<sup>27</sup>. There is a remarkably institutional diversity of Europe's welfare regimes, and this is to significantly imprint the future of integration, as the practice of national interest formulation is highly dependent on political traditions.

In the meantime, several factual observations show that, probably on a temporarily basis for some Romanian players, a handy solution to overcome or at least to prevent the intrinsic difficulties seemingly seems to rest on unconditionally embracing group pressure. A share of 91% of the firms favours lobby actions in the country, while an 88% express the same interest for lobby in Brussels, which are again the strongest levels of support<sup>28</sup>. To sustain the facts, evidence from journalistic investigations surfaces in making connections between the strong backing Romania enjoyed in 2000-2004 from the Italian government *attraverso* the European Commission (headed by an Italian) and such prosaic explanations as child adoptions by Italian families, the EADS contract of supplying monitoring systems or the official donation of valuable contemporary art paintings to the benefit of the Commission.<sup>29</sup>

The second level of preferences in joining coalitions is to play next a definite role in shaping the strategic behaviour. Two associated things are noteworthy here: the reality of a Europe which evaluates disparately Romania's image, on the one hand, and the existence of formal or informal country alliances well individualized in groups of influence. The suggested link is understood by the explanatory power of a country image perception in revealing possible directions of deepening interdependences among countries.

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<sup>22</sup> The share of companies, that haven't started organised preparations yet, ranges from 56% in Romania to 14% in Slovenia (*Corporate Readiness...*, p. 41).

<sup>23</sup> *Corporate Readiness...*, pp. 15, 41.

<sup>24</sup> Cosmovici.

<sup>25</sup> Cojanu, *Comerțul internațional*, Ciupagea et al., *Romanian Trade*.

<sup>26</sup> Ciupagea et al., *Cost-Benefit Assessment*, pp. 3, 10.

<sup>27</sup> Insightful comments are provided by Špidla; Hughes.

<sup>28</sup> *Corporate Readiness...*, p. 31.

<sup>29</sup> "Simpatia Comisiei Europene ne-a păstrat deschisă ușa UE", *Capital*, 27, 7 iulie 2005.

Romania is welcomed in the EU space by 45% of the member countries' citizens surveyed in May-June 2005<sup>30</sup>, but mean deviations are obviously indicative of various groups of interest. Romania's accession is underpinned in greater proportion by the reception extended by the New Member States (NMS) (Poland, Slovakia, Hungary, Lithuania, Latvia, Estonia and Malta), which with 50-60% of supporting answers form a robust backing group compared to the EU-15 (43%). Even individually the surveys are equally illustrative. The greatest shares, at almost two thirds of the respondents, are registered by close countries, like Greece, Cyprus or Slovenia, and considerably high percentages are characteristic for countries like Bulgaria and Croatia. As regards the EU-15, one interesting point is revealed by the polarised opinions about Romania in inversed relationship with the geographical distance: strong support from remote countries like Sweden, Denmark and Norway, but the least important encouragement (15-30%) comes from Austria and Germany.

The clarity of figures, but still more important the revealing image discrepancies are without doubt indicative of the existence of "a space of trust" to be taken advantage of. While it appears obvious not to credit this sort of statistics with more than the benefit of informative facts, it is worth mentioning that complementary economic analyses<sup>31</sup> credibly point to the creation of a pole of political and business interests in South-East Europe, viz. the region where Romania enjoys the greatest confidence. Apart from these premises, there is not yet evidence highlighting sustainable and visible interest coalitions. Instances like European-wide debates on the EU constitutional project did not find Romania aligned to whatever position. Dedicated analyses however show that there is indeed a case of ongoing clustering of arrangements among the former or present candidate countries. For instance, several authors<sup>32</sup> cannot help but notice how Germany's relative weight will increase considerably by attracting satellites-country like Poland, the Czech Republic, Hungary and the Baltic States. Frustration expressed by the minister of foreign affairs is barely hidden when a group of 15 small countries meet without Romania to envisage compensatory means for the loss of power positions conferred to them by the *Constitutional Treaty*<sup>33</sup>, the more so the balance between gains and losses has been of real concern: Romania finds itself in the position to be deprived of the influence allowed by the *Treaty of Nice*, once it had already lost decisional power by this latter pact as compared to the current system<sup>34</sup>.

It is these apparently secondary targets which are deemed to weigh heavily in guiding the integrating stakes in the future, as done in the past. From the very inception of the decisional mechanism, the main question was not to decide how much voting rights each Member State would be endowed with, but to define which groups of countries should be able to block Community decisions<sup>35</sup>. The agreement convened by the *Treaty of Nice*<sup>36</sup> abides by this Community custom and allows that at least two key elements of the decisional mechanism, namely the threshold for a qualified majority vote (QMV) and the composition of the Commission be subsequently negotiated and settled at a later date, according to the pace of accessions. Game-theoretical estimates<sup>37</sup> show, for instance, how the move of the QMV

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<sup>30</sup> TNS CSOP, *Eurobarometrul 63.4. Raport național România*, primăvara 2005, pp. 23-24.

<sup>31</sup> For example, Cojanu, *Factual Observations*.

<sup>32</sup> Yataganas, p. 40.

<sup>33</sup> "România, de partea celor mici în disputa privind Constituția Europei", *Ziarul Financiar*, 8 September 2003.

<sup>34</sup> This conclusion is based on Bobay, p. 15.

<sup>35</sup> Bobay, p. 10.

<sup>36</sup> References are made to the *Treaty of Nice*, as well as to the therein included documents, namely, "Protocol on the Enlargement of the European Union" and "Declaration on the Qualified Majority Threshold and the Number of Votes for a Blocking Minority in an Enlarged Union".

<sup>37</sup> Bobay, p. 12, Yataganas, p. 40.

threshold from the current 71% to a maximum of 73.4% creates many more possibilities for the formation of blocking coalitions, the more so *ad hoc* adjustments in the QMV percentages are likely to be negotiated. With no doubt, these are all indicative of a domain open to strategic interactions among states, a rather different context as compared to the accession negotiations. The inherent combination of these aspects with the well-established policy-making practices makes the right adjustment to the outlook of a post-enlargement Europe.

## **I 2 A political economy guide to the EU policy-making process**

The Community decision embodies the process whereby the Member States decide together on the provision of certain public "goods" that affect them all.<sup>38</sup> "Goods" in this context can mean several things, including traditional public goods like "defence" or "legal framework", or rather in the form of "common policies" in such fields as trade, agriculture and monetary policy. When the production of these goods becomes centralized at an important scale, the integrating region takes advantage of scale economies and externalities in the decisional process, a strong reason to extend integration to the point where the benefits of decentralization overwhelm in importance. Nevertheless, a good strand of literature complementary to this orthodox position, for instance liberal inter-governmentalism, social institutionalism or pivotal votes theory, proves by means of consistent factual observations the reason why the often unpredictable interest interplay at both national and Community level may bear out a more plausible understanding of decisions. Both perspectives therefore suggest that an adequate view on the decisional mechanism should simultaneously consider the scope of Community decisional power and the institutional arrangements as regards voting validity.

Against the theoretical expectations which propose a gradual transfer of traditional attributes of sovereignty toward the place of Community decision, the factual observations come as indubitable confirmation. **Table 2** illustrates the division of prerogatives between European domains of policy-making.

**Table 2:** Domains of EU policy-making and its legal scope

Policy domains	Shares of Community legislation *						Shares of legislation in force	Shares of Court decisions **
	1971 -75	1976 -80	1981 -85	1986 -90	1991 -95	1996 -00		
<b>1 International Trade:</b> International agreements; goods/customs duties	33.1	40.2	24.5	26.5	22.2	17.9	17.6	10.0
<b>2 Common Market:</b> Internal market legislation; Services/establishment rights; Capital; People	5.1	3.9	2.0	2.1	2.4	4.6	7.0	20.4
<b>3 Money and Finance:</b> Monetary policy; Taxation	1.9	1.1	1.1	0.5	0.8	2.2	1.7	11.0
<b>4 Education, Research &amp; Culture</b>	0.6	0.6	0.8	0.8	1.4	1.2	0.8	0.0
<b>5 Environment</b>	1.1	1.0	1.1	1.0	1.6	2.2	2.8	6.2

<sup>38</sup> A theoretical exposition may be found in Pelkmans, *Integrare europeană*, pp. 48n; Alesina et al.; and Casella.

Policy domains	Shares of Community legislation *						Shares of legislation in force	Shares of Court decisions **
	1971	1976	1981	1986	1991	1996		
	-75	-80	-85	-90	-95	-00		
<b>6 Business relations / Sectoral:</b>	44.2	47.6	63..0	56.4	56.8	47.6	45.8	18.2
of which: Agriculture & Fishery	37.5	38.7	57.2	53.3	53.0	43.0	40.5	15.4
Industry & Energy	4.2	6.9	4.5	2.3	2.5	3.2	3.1	0.1
Transport	2.5	2.0	1.2	0.8	1.3	1.4	2.2	2.7
<b>7 Business relations Non-Sectoral:</b>	4.4	2.1	2.8	2.8	5.3	12.3	15.2	20.8
Competition; Subsidies; Company law								
<b>8 International relations and aid:</b>	5.9	1.6	1.8	5.9	3.4	4.4	3.0	3.5
Multilateral co-operation; Foreign policy; Defence; Foreign aid								
<b>9 Citizen &amp; Social protection:</b>	3.7	2.0	2.9	4.0	6.1	7.5	6.0	10.0
Migration; Crime local/global; Health and social welfare; Unemployment; Social exclusion; Regional aid								
Total	100	100	100	100	100	100	100	100

Source: Based on Alesina et al., "What Does The European Union Do?"

\* *Regulations, Directives, and Decisions.*

\*\* *Judgements and Opinions* (June 1997 - March 2001).

The legal scope suggested by these statistics of legislation points to various grades of influence of the Union, whose evolution appears visible both on a sectoral basis, and in time. Three developments are worth mentioning here. The first refers to a gradual decline by half of the relative position of "international trade", the original determinant of integration. This result comes naturally, as the integration process became mature and it is nonetheless indicative of a consistent accumulation of decisional accountability in Brussels over a three – four decade long exercise of Community influence. The second trend shows the emergence of new regulatory domains, such as "education, culture and research", "environment" and "citizens and social protection", each of them witnessing a doubling in relative position. Interestingly, this advancement was accompanied by the creation of a public space of ignorance in relation to the new concerns of the Union, otherwise much less probable to be formed at the national level. For example, even as one may notice the steady front placement of "education and research" among the EU budgetary outlays, ranked third after "agriculture" and "structural policy", a survey<sup>39</sup> is evidence for the fact that only 17% of the respondents are informed about the main expenditure item, while 31% of them place the administrative costs on top.

Finally, a third evolution characteristic for the scope of the Community legislation sheds light on the strengthening of central regulatory powers for the business sector, 60% compared to 50% of legislation in force over the examined period, with a considerable increase for the non-sectoral domains (competition, subsidies, enterprises). This policy ramification, along with that of "common market", in fact equally important for businesses, gives also birth to most CJ deliberations (ca. 60%) relative to *acquis* compliance.

<sup>39</sup> *Eurobarometer*, p. 123.

To sum up, these evolutions encapsulate two general trends as to the legislative power of the Union: a continuous and extensive widening of the scope of Community decisions and a strengthening of business regulations at the Community level. At least one implication imposes itself: the member countries do not seem fully prepared to further absorb this linear institutional transformation and, hence, to give preference to a political model of governance either intergovernmental or federal. It is highly perceptible an increase in the number of those members who do not want the European Union to play a more important role in 5 years than today in such countries as The Netherlands, Ireland, the United Kingdom and Sweden<sup>40</sup>. This sort of unpredictability is sustained by academic research which puts forth arguments that "at present, nobody can tell for sure whether the EU is moving toward a system in which the member states remain the principal actors or whether the EU is going in the direction of some kind of "United States of Europe" in accordance with the federal model."<sup>41</sup>

On the other hand, the consequences of several moments crucial for the future of Europe, such as the creation of a Common Market in 1992 or the successive enlargements, are not being given due recognition in that statistics referring to the scale of Community interference. What has however become manifest is that any of the nine policy domains may take a course of development with far-reaching implications for the EU evolution. Such was the case when delineation appeared between those member countries which formed the euro zone and adopted or envisaged to adopt a common currency and those remaining members which decided to keep the monetary independence (the Great Britain, Sweden, and Denmark). A recurrent manifestation of similar institutional milestones is expected to find new impetus in the time to come. Besides that legislative agglomeration accused by certain member countries, the ca. five fold growth of membership since the founding considerably impedes the predictability of Community decisions and, at the same time, makes the anticipated impact of regulations vulnerable. With reference to recent legislative years, ca. 80% of the acts were passed by consensus<sup>42</sup>, a practice which seemingly represent after several revisions still the prime decision making mechanism. The balance between the national interests and the Union policy so becomes ever more fragile by keeping with voting *conventions* which allows for the creation of interest coalitions and multiple interferences of external actors.

The voting importance rests on the corresponding area of regulation and on the voting procedure. There is first a fundamental difference between the pillar I and the other two. The EU institutions, here including primarily the Council of Ministers (CM), the European Commission (Com) and the European Parliament (PE) can make legislation which is *directly applicable* and has *primacy* over individual members' law for first pillar issues. In contrast, any decision concerning the two other pillars requires unanimity, and must be approved by national Parliaments to become applicable in member states. A peculiar institutional aspect consists in the provision that, save as otherwise provided, the Council shall act by a majority of its members (Art. 205, *Treaty Establishing the European Community*), which would made *de jure* unanimity and QMV procedures by exception<sup>43</sup>.

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<sup>40</sup> *Eurobarometer*, pp. 128-129.

<sup>41</sup> Meerts and Cede, p. 10.

<sup>42</sup> Heisenberg in Meerts and Cede.

<sup>43</sup> Out of 75 provisions under unanimity, 27 were indeed transformed into QMV. These include areas of trade in services and commercial aspects of intellectual property. Cohesion policy was shifted to QMV, but only after 2007 when the new financial budget is determined until 2013. A veto was kept for a number of important policy issues such as taxation, social policy and the major elements of the policy on asylum and immigration (Yataganas, pp. 36-38).

However, the latter two represent highly sensitive Community practices, as previously suggested. The *Luxembourg Compromise* resolved the crisis in the Council of Ministers of 1965-66 between France and the other five member states – a *de facto* concession to each MS of a right of veto on any Community proposal, where a self-defined vital national interest was at stake. Although it still is a working convention, the *Compromise* remains a key factor for decision-making by substantially diminishing the scope for Community initiatives. Consequently, QMV-based decisions may be unanimously agreed if a country invokes its vital interests. The agricultural policy, where no major decision would be taken without the consensus of France and Germany<sup>44</sup>, the regional policy, where Spain has been successful to retain a national veto over all EU decisions on regional aid<sup>45</sup>, are examples whose significance is given by their foremost priority among the budgetary outlays.

Leaving aside this historical approach, the consensual decision within an Union still dominated by marked differences of opinion, together with the possibility of QMV in an Union increasingly enlarging with small states, constitute highly influential determinants on Community policy-making. Willingness to find and make concessions, ability to link bargains in different issue areas, propensity to engage in coalition formation at an early stage are all attributes of national interest representation, whose inevitability was not so vigorously considered until accession. The voting issues and the decision's are however hard to be straitjacketed in a unitary theoretical treatment, as the arguments favour an analytical-based approach of the contextual details<sup>46</sup>. The EU policy-making does not escape the latter implication as it has decisively become subject to *ad hoc* working conventions. There are two convergent directions on which these conventions build up the Community practice: a formal one, of the decisional centres and advisory bodies, and an informal one, of pressure groups.

Formally, the Community policy takes shape in five major power centres – the Intergovernmental Conference (ICG), the European Council (Con), the Council of Ministers (CM), the European Commission (Com) and the European Parliament (PE) – which alongside the activity of other advisory institutions, such as the Economic and Social Committee, the Committee of Regions or the Committee of Permanent Representatives (COREPER), conclude the reasoned opinion of this main decisional scaffolding. As each of these points of decisions is permeable enough to allow particular sources of influence, the general route to the legislative act inevitably becomes conditional on *rules* and *practices* of decisions.

The reason to explain the apparently incomprehensible decisional mechanism thus becomes especially related to the role the special interest groups play in outlining the Community policy. The outset is given by the official choice of the Union to agree the principles and the procedures of those interventions, although when considering their scale one may have the true proportions of a shadow Community. In 1992, the Union made public its official position on interest groups<sup>47</sup>, designated a web page to this issue<sup>48</sup> and estimated that there were about 3,000 interest groups (both national and European) active in Brussels and Strasbourg, employing around 10,000 people. It is however about a belated circumstance to take up position on just ordinary and seemingly influential Community practices: a study's documentary evidence shows that in 1985 a share of 12% out of the then ca. 500 interest

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<sup>44</sup> Alesina and Perotti, pp. 4-5; "The Franco-German Monster", *The Economist*, 25 October 2005.

<sup>45</sup> "Joining the West", *The Economist*, 17 May 2001.

<sup>46</sup> An extended discussion on that point, as well as an application to the negotiations with the EU are provided by Cojanu, *The Integration Game*.

<sup>47</sup> Commission of the European Communities, "An Open and Structured Dialogue Between the Commission and Special Interest Groups", SEC(92)2272 fin, 2 December 1992.

<sup>48</sup> [http://europa.eu.int/comm/secretariat\\_general/sgc/lobbies/index\\_en.htm](http://europa.eu.int/comm/secretariat_general/sgc/lobbies/index_en.htm).

groups had been emerging before the EC founding, while 52% of them constituted in the first four years of functioning<sup>49</sup>.

The European lobbying landscape is extremely fragmented: out of the interest groups which had (in 2000) a permanent office in Brussels, 32% were European trade federations, 20% commercial consultants, 13% companies, 11% European NGOs, 10% national business and labour associations, 6% regional representations, 5% international organizations and 1% think tanks<sup>50</sup>. What is the more so interesting when compared to the notable population of interest groups is that most parliaments of the Member States do not have any specific rules or provisions governing their activity or their representatives, with the important exceptions of Germany and the UK<sup>51</sup>. Even if it is reasonable not to think of a pervasive penetration of the Community legislative scope by organized pressure influences<sup>52</sup>, in November 2002, the EU list of non-profit organisations included around 700 groups, divided into 27 categories according to policy areas, which by and large overlap the main domains subject to Community regulatory authority as depicted in Table 2.

A first informed perspective on the characteristics of pressure actions is suggested by the numerous terms which are used in everyday language to describe these organisations: interest groups, pressure groups, lobbies, promotion groups and so on. For instance, in the EP parlance, lobbyists are defined as "persons who wish to enter Parliaments premises frequently with a view to supplying information to Members in their own interests or those of third parties"<sup>53</sup>. A similarly articulate description of the pressure objectives is the *PPP* formulation, namely "to place the friendliest *persons* in the best *positions* in the most beneficial *procedures*."<sup>54</sup> To confirm an established tradition, the practice of pressure consecrates a distinct occupational domain under denomination of *the Public Affairs Management (PAM)* which is nurtured by such an extremely fertile environment comprised of organisations as the like of *Society of European Affairs Practitioners (SEAP)*, *Association of Accredited Lobbyists to the European Parliament (AALEP)*, *European Federation of Lobbying and Public Affairs (FELPA)*, *European Centre for Public Affairs Brussels (ECPAB)*. The academic research is dedicated academic journals, as for example the *Journal of European Public Policy*.

In spite of the simplicity and meaningfulness of terms and descriptions of formally organized interests, it is however less evident how the lobby efforts are actually carried out and to what extent their supposedly influential point of view gets eventually adopted. A conceptual framework is proposed in the literature<sup>55</sup>: the interest groups spread along *vectors of Europeanization*, namely those originating from combinations of at least two sources of influence as structured by the European public sector, the national public sector, the European private sector, and the national private sector. From both public and private perspective, **Table 3** gets together the formal and informal criteria which may practically bestow an interest group the posture of dialogue partner for the Community.

**Table 3:** Rationales for the activity of special interest groups

*Objectives at the Community level*

*Objectives at the interest group level*

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<sup>49</sup> Philip, p.30.

<sup>50</sup> Van Schendelen, p. 46.

<sup>51</sup> Lehmann, p. 43.

<sup>52</sup> Philip, p. 82.

<sup>53</sup> Lehmann, p. iv

<sup>54</sup> Van Schendelen, p. 105.

<sup>55</sup> van Schendelen, p. 31.

*Objectives at the Community level*

The Commission (Com) has to rely upon outside bodies to supply it with much of the information it needs in order to initiate proposals or to implement agreed policies.

Factual information which may be slow arriving from national governmental sources.

The Com proposal is sent off for scrutiny by national governments, pressure groups and other affected parties.

The pressure group may be determined to put off its decision to take the case to the Court of Justice.

Assist rapporteurs (of the European Parliament, ECOSOC) with the preparation of their reports.

Hope to attract support, knowing that proposals that are opposed by affected interest groups are far less likely to survive the scrutiny of the Council of Ministers.

The affected interests may be closely involved in subsequent implementation of the very same proposals by drawing more interests into the Com net.

The Com hopes to build a stronger Community.

*Objectives at the interest group level*

Contributing to the elaboration of Community legislation by providing their technical expertise.

Obtaining subventions and participating to calls for proposals in the managing of Community programmes.

To obtain information from the Com about its current policies and its future plans, and the state of play on any particular subject.

As a mark of recognition, thus adding to their own legitimizing with the interests they try to represent.

Hope to influence the attitudes and behaviour of Com officials whose work touches on their own field of concern.

Much of a company's economic environment, including access to markets and rules on technical standards, collaboration with competitors, and company law is subject to the EU commercial and competition policies control.

Raise the alarm about abuses of Com rules, most commonly in the field of competition policy and of failures to observe trade agreements and practices.

Trade representatives and companies have often to ask the Com to take retaliatory action on behalf of the Com to ensure that the terms of existing trade agreements are adhered to.

Source: The compilation is based on Philip; Lehmann.

The collected information in Table 3 is convincing enough to point out on conclusive terms that the EU has continuously developed into an organisation founded on a deliberately transparent process, even if so heavily dependent on the way public and private interests coalesce so that "collective action is the rule rather than exemption"<sup>56</sup>. Some authors ascribe positive effects of this interplay of interests to the European integration process: the pressure groups articulate their pluralist interests thus "making possible the formation of new EU agendas and policies closer to the citizens" the most professional contribute to EU democracy<sup>57</sup>.

It is nevertheless difficult to accept such claims without qualifications in the sense that the *rule* of organized influence on decision may be seen to represent a public policy standard. The empirical conclusions implied by Olson's theory of collective action consistently converge to explain the increasing vulnerability of the EU economic performance, as compared to other regions of similar development, as a side product of the effective influence of the pressure groups. Symptoms of this institutional failure remain highly visible in the

<sup>56</sup> Van Schendelen, p. 128.

<sup>57</sup> Van Schendelen, p. 316.

collected information. The public rationale of a close involvement in the implementation in the Com net (Table 3, column 1) appears rather frail into the view that "the legal texts have become so complicated"<sup>58</sup> to the extent of diminishing the capacity for policy execution. Similarly, the private option for "legitimacy" (Table 3, column 2) is severely affected by the evidence that "a Euro Fed is seldom representative of the whole of the sector"<sup>59</sup>. Moreover, the EU strategic vision to become closer to its citizens rests on shaky foundations as long as the reality of popular opinions in several Member Countries, as presented in the previous section, speaks of a less moderate aspiration towards an increased Community control on people's life or businesses.

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<sup>58</sup> Meerts, Paul W. and Franz Cede (Eds.), *Negotiating European Union*, IIASA Austria: Palgrave MacMillan, 2004, p. 11.

<sup>59</sup> Van Schendelen, Rinus, *Machiavelli in Brussels. The Art of Lobbying the EU*, Amsterdam: Amsterdam University Press, 2003, p. 115. There exist, for example, about 15 EuroFeds dealing with construction, 20 with packaging and 75 with chemicals. Many of them are not broadly European for their sector, but regional and trade-specific.

## **II Strategic focus #2: Policy scope**

### **II 1 Industrial and competitiveness policy**

The problems of the insufficient competitiveness of the European Union in a global context are far from being recent (from *Le défi américaine* to *Le défi mondiale*). However, in the first years after the Treaty of Rome entered into force, the member states were the ones who dealt with the situation of national industries. In the '70s, once the Community launched its Industrial policy, the competitiveness was finally somehow included in that policy. Anyway, the main orientation was towards the support of some sectors like steel industry and shipbuilding, both in order to ensure their survival under the tough conditions caused by the oil crisis and to maintain the jobs in those sectors. During the last two decades, the Industrial policy of the EU re-oriented from sectors to enterprises, business environment and competition.

At the beginning of the '90s, the EU clearly stated a great interest in increasing the competitiveness, taking into account the assessments of the EU economy ranking in the global context and the challenges of the New Millennium, as well<sup>60</sup>.

Why does the competitiveness come first? The answer relies in the concept itself, which is a very complex one, depending on many factors, but which basically means certain productivity - the only welfare source.<sup>61</sup> The acknowledgement of the competitiveness gaps, using the comparison with USA, led to the necessity to formulate and launch a new strategy in the field, which happened in March 2000, at the European Council in Lisbon. The objective launched at that moment was for the EU "to become the most competitive and dynamic knowledge based economy, capable of sustainable economic growth, with more and better jobs and with stronger social cohesion, until 2010"<sup>62</sup>. Analysing the Lisbon objectives we can notice their orientation towards the 3 pillars of competitiveness:

- a) "Technical" conditions for strengthening the competitive position of the European Union: undoubtedly, the ones that matter today in terms of competitiveness, meaning research-innovation, communication-IT.
- b) Economic conditions: the macroeconomic stability, already achieved, was supposed to facilitate some positive effects on sustainable economic growth, by removing barriers for the full liberalisation within the Internal Market, especially by creating an environment more open to competition, by a greater liberalisation of services, by a better development of integrated financial services and a better business environment for enterprises, meaning an improved legal framework, less bureaucracy, etc;
- c) The social component, which refers to employment (economic growth and jobs) the training of the labour force to adapt to the conditions of the '*knowledge-based economy*', but also the so-called "modernisation" of the social security system. The intention to perform

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<sup>60</sup> European Commission, *An industrial competitiveness policy for the European Union*, Bulletin of the European Union, Supplement 3/94; The European Commission, *White Paper on Growth, Competitiveness and Employment, the Challenges and Wages forward into the 21<sup>st</sup> century*, COM (93) 700 final, Brussels, 5 dec. 1993, Chap. 2: "The conditions for growth and enhanced competitiveness" European Council, 23 and 24 March 2000

<sup>61</sup> See, Porter, World Economic Forum: interview at the launching of the Global Competitiveness Report 2005-2006, published in <http://www.weforum.org/site/homepublic.ns.../Global+Cmpetitiveness+Report+2005-2006%A+Interview+with+Michael+Porter>

<sup>62</sup> Presidency Conclusions, Lisbon European Council, 23 and 24 March 2000

some changes in the European social security system is obvious, which is extremely generous, in order to match it with the economic, demographic and also with public budget limits.

The main findings of periodical evaluations on competitiveness, as they appear in European Commission's reports on competitiveness, but also in some independent bodies' reports, like World Economic Forum, refer both to the degree of achieving the Lisbon objectives (the 8 objectives) and to the EU situation compared to the USA. The information sources for these evaluations are mainly EU statistical data regarding the macro and micro economic environment, and some comparative evaluations regarding the ranking of a certain group of countries, as the one realised by World Economic Forum. Following this particular goal, the WEF based its analysis on two synthetic indexes: the Growth Competitiveness Index<sup>63</sup>, in the last report applied to 116 countries, and the Business Competitiveness Index<sup>64</sup>, which is a synthesis of empirical researches' results based on a questionnaire on investors' opinions about the business environment). The main findings concerning the EU situation, resulted from several evaluations, are the following:

- No EU country reached the maximum points for any competitiveness indexes. The countdown, based on medium points, is as follows: three Nordic countries (Finland, Denmark, Sweden) ranked in the first positions, in the middle we find United Kingdom, Netherlands, Germany, Luxembourg, France, Austria, Belgium and Ireland; at the lowest level we find the Southern countries (Spain, Italy, Portugal and Greece). The European Union not only has not achieved the objectives on competitiveness but, it is still a heterogeneous area in terms of performance level established at Lisbon. In the same time, in each country, we can identify certain gaps in terms of performance levels. These gaps suggest that the EU policy refers only to the common aspects, the member state being responsible for identifying the specific measure in the vulnerable domains.
- The comparison between the EU and USA, based on the same criteria, clearly shows that, on average, the UE score is below the USA one (even if the three Nordic countries register a higher score than USA)<sup>65</sup>. USA registered the highest score, surpassing the three Nordic countries, in terms of innovation (EU spends only 1,9% of the GDP for research and development, compared to the min. 3% established at the European Council in Barcelona, and compared to more than 3% allocated by USA) and the quality of the business environment, which explains the EU lower level of competitiveness compared to USA (GDP/capita in UE is around 70% of the USA's GDP/capita); the domains in which EU surpasses USA are social protection, environment and sustainable development, telecommunication.

The results are the same with the ones in the last two years, revealing that the EU progress in this field was less visible. From various presentations, made by European Commission's representatives, we can identify the main causes which have led to the present situation: the maintenance of some barriers within the Internal Market, the weak reaction of

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Note: the comparisons on competitiveness regard almost exclusively USA, rarely mentioning the high competitive pressure on trade, for the moment, only with some goods from China and India.

<sup>63</sup> The most recent evaluation of 116 countries, made by WEF, using the GCI index can be found in Global Competitiveness Report 2005-2006

<sup>64</sup> Concerning the meaning of BCI, see Porter, E. Michael (2003), "Building the Microeconomic Foundations of Prosperity: Findings from the Microeconomic Competitiveness Index", in WEF, Global Competitiveness Report 2002-2003, Chap. 1.2.

<sup>65</sup> Blanke, Jennifer and Augusto Lopez-Carlos (2005), *The Lisbon Review 2004. An Assessment of Policies and Reforms in Europe*, World Economic Forum, pg.4-8; see also Kroes (2005), "Building a Competitive Europe- Competition Policy and the Relaunch of the Lisbon Strategy", Speech addressed to a conference at Bocconi University, Milan, 7<sup>th</sup> February 2005, Reference: SPEECH/05/78

the business to the introduction of *Euro*, the insufficient highly qualified labour force, the low funding for the universities, but also their weak connections with the business environment, and the weak entrepreneurial culture.

The economic indicators which reveal the insufficiently positive evolution or, even a negative evolution of EU, are the following<sup>66</sup>: relatively moderate rhythm of re-launching the economic growth, of only 2,5% in 2000 (the result was positively influenced by including the dynamism of the *new comers*, while the “*old Europe*” registered a very low growth rate which reveals that the enlargement is an opportunity for the EU, not just the opposite); the budget deficits above 3% of GDP, established in Maastricht Treaty for more than 1/3 of the EU members; the high unemployment rate, even if the productivity decreased, which means that, on one side, Europe has still insufficient business opportunities or/and the setting up of a business is still difficult, and on the other side, that the social security system is too protective, without exercising a pressure towards employment, and in the same time, the labour market is not flexible enough to absorb unemployment. In other words, in the EU, the costs of the social security system is extremely high, and hampers the competitiveness of the companies which compete with American companies, better placed in this respect. EU is also disadvantaged, in terms of employment rate (in 2002 it was only 68.2% in Euro zone, compared to 76.4% in USA)<sup>67</sup>, which stresses the need for radical reforms of the pension system, following the demographic changes, the ageing process, but also the increase of medium life duration.

Therefore, for answering the question - to what extent is the European model still sustainable - Sapir noted that, in Europe, the economic growth process was based more on imitation than innovation so, a profound reform of various market components, especially of the labour market and of the educational system (Blanchard) is completely justified<sup>68</sup>. Moreover, it is accepted that the economic development model will radically change in the next 20 years, in the sense of reducing the weight of classic manufacturing industry and increasing of those knowledge based industries and services. Normally, such a development definitely involves the increase of the educational level. The EU orientation, in this field, may be synthesised as follows: "Europe must strengthen its three poles of the knowledge's triangle: education, research, innovation. In every one of them, the role of universities is essential. To invest more and better in the modernisation and the quality in Universities means to invest direct in the future of Europe and Europeans." <sup>69</sup>

Taking into account these aspects, the re-launch of the Lisbon objectives targets strengthening those areas, initially included in the Lisbon project, in order to increase the chances for economic growth and job creation<sup>70</sup>, respectively: the enlargement and deepening of the Internal Market, the improvement of the European and national legislation, better infrastructure and investments in research and development, supporting innovation and ICT sector, plus the use of resources in order to ensure sustainable development; increasing the

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<sup>66</sup> Kroes (2005), Speech, Bocconi University

<sup>67</sup> European Central Bank, 2004, p. 20

<sup>68</sup> See Sapir, Andre (Chairman; 2003), “ Ch. 7 – Is the European model sustainable” in *Agenda for a Growing Europe. Making the EU Economic System Deliver*, July 2003, pp 93-97; Blanchard, Olivier (2004), *The Economic Future of Europe*, NBER Working Paper Series, Working Paper 10310, February 2004, <http://www.nber.org/papers/w10310>

<sup>69</sup> Commission of the European Communities (2005), *Mobilizing the brainpower of Europe: enabling universities to make their full contribution to the Lisbon Strategy*, Brussels, 20.4. 2005, COM (2005) 152 final, p. 2

<sup>70</sup> Details on each objective's content can be found at: [http://europa.eu.int/growthandjobs/pdf/SEC2005\\_192\\_en.pdf](http://europa.eu.int/growthandjobs/pdf/SEC2005_192_en.pdf)

employment rate, and again, the idea of modernising the social security system, and increasing the adaptation of the business environment and labour market.

What is new in the re-launched Lisbon project refers to the emphasis on a new model of governance, a better distribution of commitments and responsibilities, between the EU and the member states<sup>71</sup>, for each objective. The purpose is to achieve a higher involvement of the states for the general objective of increased productivity and competitiveness. The European Commission elaborated several initiatives at the EU level; some of them became programs aiming to promote the idea of public – private partnership, which to support the technological progress and innovation, targeting the increase of productivity and competitiveness. In this respect we mention:

*EUREKA* – an initiative from 1985, initially a French-German project, and now involving 34 countries. Eureka is meant to promote innovative projects in the manufacturing industry, with the support of a financing partnership – public, with 30% and private, with 70%. Eureka consists of a network of R&D market oriented projects. Basically, Eureka promoted the idea of creating some competitiveness clusters especially through developing IT and energy technologies and biotechnology<sup>72</sup>.

*European Technology Platform and Joint Technology Initiatives* - In order to facilitate the achievement of the Lisbon objective and to increase funding for research, according to what was established at the European Council in Barcelona, *id est* for 3% of the GDP, of which 2/3 to be private contribution, the European Commission elaborated a proposal introducing the concept of JTI (Joint Technology Initiatives)<sup>73</sup> - as a new way of creating public – private partnerships at European level. The European Technology Platforms, which meant to direct research towards the most important technological objectives the future European competitiveness depends on, will be financially supported by FP7, as well as, according to the regulations, by state aids and private support. The result should be the creation of a cluster network, and research potential and resource networks in Europe.

*The presence of clusters in some countries* – Porter's ideas concerning competitiveness<sup>74</sup> and its promotion through clusters have been rapidly adopted, the most active regions being: Catalonia in Spain, Lombardia in Italy, Rhône Alpes in France, Yorkshire in the United Kingdom. To exemplify, in the '70s when the European Community's Industrial policy was launched, France promoted the idea of *pôles de croissance*, which aimed to provide firstly support for infrastructure in order to attract investments, and to contribute to economic growth. In today's current situation, the French government adopted, in December 2002, several decisions regarding the strategy of the Industrial policy focusing on the key factors of competitiveness. This was the context for initiating a policy of supporting competitiveness clusters (*pôles de compétitivité*). The launch of this governmental initiative took place through a circular letter sent by prime-minister *de*

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<sup>71</sup> Commission of the European Communities (2005), *Lisbon Action Plan Incorporating EU Lisbon Programme And Recommendations For Actions To Member States For Inclusion In Their National Lisbon Programmes*, Companion document to the Communication to the Spring European Council 2005 {COM (2005) 24}, "Working together for growth and jobs", [http://europa.eu.int/growthandjobs/pdf/SEC2005\\_192\\_en.pdf](http://europa.eu.int/growthandjobs/pdf/SEC2005_192_en.pdf); see also Barosso, J. M. (2005), "To Lisbon and beyond: Market access and external aspects of competitiveness", Opening address – Market Access Symposium, Brussels, 19 September 2005

<sup>72</sup> Details in: <http://www.eureka.be/thematic/aboutStrategicInitiatives.do>

<sup>73</sup> See, Commission Staff Working Document, "Report on European Technology Platforms and Joint Technology Initiatives: Fostering Public-Private R&D Partnerships to Boost Europe's Industrial Competitiveness", SEC (2005)800, 10.6.2005.

<sup>74</sup> Porter, E. Michael (1990), *The Competitive Advantage of Nations*, Free Press, pp. 545-560

Villepin to the Prefects and referring to the conditions to be achieved and the procedures to be followed in order to benefit from governmental support. A number of 67 competitiveness clusters will benefit from French governmental support. The sums allocated to this initiative will be around 3 billions Euro, for 2006 – 2008, to which the EU structural funds will be added, FP6/FP7 for research, funds from Eureka, plus sums from public-private partnership (intervention credits from Ministries, support from public agencies for research and innovation).

After 2000, the idea of organising clusters reached Central Europe, too. The situation is different from one country to another<sup>75</sup> – from Slovenia - the first country which integrated this concept into a pro active Industrial policy supporting SMEs and allocating important financial resources for upgrading the innovation level – to Poland, where certain clusters aggregated spontaneously especially in high tech sectors, but the cluster concept did not become an instrument for Industrial policy. Even if Hungary is not the most spectacular case in terms of clusters, the case is worth mentioning because of the launching of a new economic policy called „Smart Hungary”<sup>76</sup>, having the intention of using the cluster of Universities and research institutes based in Budapest in order to strengthen the links with the most dynamic companies.

In the case of Romania we find only one cluster mentioned by authoritative studies<sup>77</sup> respectively the concentration of shoe industry of medium quality, due to the presence of an important number of Italian companies, in the Timisoara area. The same cluster is mentioned as an extension example of an already existing cluster in Montebelluna, Veneto<sup>78</sup>. The profile of the economic sector will result from this bottom-up development and it will be not designed as an instrument of the traditional economic policy, which is, in this case, impossible to promote and which, would definitely lead to a failure.

## **II 2 Monetary policy**

The European Central Bank (ECB) is an independent bank, and the role of its monetary policy has been well defined<sup>79</sup>. The aim of the EU monetary policy is to reach macroeconomic stability through monetary stability and fiscal discipline at the euro zone level that is also the necessary condition, even not the only one, for welfare, economic growth and jobs. To this end, the ECB has stipulated in its statute a clear quantitative objective, *id est* to reach a low inflation rate at a level of 2%. Concerning the fiscal discipline, the requirement is as it was stipulated in the Maastricht Treaty (budgetary deficit of 3% maximum level in GDP; 60% of GDP maximum public debt), and according to the implementations rules of these requirements, as they are stipulated in the Stability and Growth Pact (SGP), amended on 22 March 2005<sup>80</sup>. The new SGP maintains the rules about budget deficit and public debt, but introduces a certain flexibility regarding the corrective measures, in order to respond better to the diversity of economic situations in the EU.

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<sup>75</sup> "Business clusters: promoting enterprise in Central and Eastern Europe. Executive summary", in <http://www.oecd.org/dataoecd/7/8/35136722.pdf>

<sup>76</sup> Project description in : <http://www.competitiveness.org/bulkmail/view/6>

<sup>77</sup> Ketels, 02 June/2004 p.1

<sup>78</sup> [http://www.competitiveness.com/nps/corporate/com/en/services/intercluster\\_initiatives.html](http://www.competitiveness.com/nps/corporate/com/en/services/intercluster_initiatives.html)

<sup>79</sup> Details in, Duisenberg, 1998

<sup>80</sup> "Resolution of the European Council on the Stability and Growth Pact", Amsterdam, 17 June 1997, Official Journal C236. 02/08/1997 P.0001-0002; see also, European Council, Spring summit of EU leaders – Presidency conclusions on Stability and Growth Pact (Annex II – p. 21-39 on stability pact), 22-23 March 2005), [http://ue.eu.int/ueDocs/cms\\_Data/en/ec/8](http://ue.eu.int/ueDocs/cms_Data/en/ec/8)

It is important to notice that the low inflation objective is not an aim *per se*, but only a way to reach welfare. ECB succeeded to reach the low inflation objective, low interest rates, and generally, an obvious macroeconomic stability. In spite of this, the euro-zone economy, as a whole, is situated in a not satisfactory place in the global context of competitiveness (see, Reports on global competitiveness published by the WEF the last years, but the EU reports on competitiveness as well), and, especially, the EU did not succeed to have an economic growth high enough to create more jobs and to reduce the unemployment rate. We might even agree with Svensson in that ‘excessive ECB fixation on price stability, in the context of nominal rigidities, would reduce inflation and price volatility, but paying the price of an output volatility’<sup>81</sup>, we cannot blame the monetary policy for being the source of this lack of economic success. Rather, we have to take into consideration that other adjustment mechanisms must be activated for shock absorption, and even to reconsider the meaning of price stability in the euro-zone, in order to let the price mechanism to play an adjustment role in the case of certain shocks. Moreover, this might have significance too: the confirmation (see, Porter) that the main sources of economic growth today are to be found beyond the classic instruments of the macroeconomic stabilization policies.

Surely, the ECB monetary policy, even being independent, cannot ignore the economic situation in the euro zone. Moreover, there is a provision in the ECB statute which is referring to the support that the European Central Bank may provide to other Community economic policies, without prejudicing the price stability<sup>82</sup>. The need for harmonization of policies mix and of certain reforms that should offer solutions to the economic and social EU problems is more than obvious: the pension system reform, the in-depth reform of labour market, the development of a ‘push’ innovation policy, and a more attractive business environment. The limits of European social model are also questioned.

ECB is independent regarding its monetary policy, but its potentiality of interventions is rather limited. According to the theory of optimum currency area, the monetary policy has to reply to shocks that might hit the economy in the euro-zone. It is known that the ECB monetary policy may address only the common shocks in the euro-zone, especially to the domestic shocks that are generally of temporary type. If the economy in the euro-zone is under external shocks, for instance the shocks that come from the world market (the increase in the oil price) or shocks of the global competition (ex. the shock of technological changes, or strong fiscal competition)<sup>83</sup>, these are the objectives of other macro or microeconomic policies.

More recent studies<sup>84</sup> came to the conclusion that in the euro-zone in its present formula, seems to have been reached a reduction in the inflation rate differential among the member states, respectively a significant harmonization of business cycle<sup>85</sup> that means the increased chances of success of certain Community measures meant to defend against shock effect. According to the present ECB governor<sup>86</sup>, even if some inflation differential still exists, this might be accepted as equilibrating mechanism in a wide economic area such as

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<sup>81</sup> Svensson, 2002, quoted in Sapir (2003), p.42; a similar opinion one may find in Lavrac, 2002, Working Paper No 14, p. 4

<sup>82</sup> “The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability it shall support the general economic policies in the Community”, ECB, 2002, p.2; quotation in Aguiar and Martins (2005), p. 232; see also European Parliament, European Parliament Fact Sheets, *European Monetary Policy*, Legal Basis, [http://www.europarl.eu.int/facts/5\\_3\\_0\\_en.htm](http://www.europarl.eu.int/facts/5_3_0_en.htm)

<sup>83</sup> See explanations regarding the mechanism of this kind of shocks in, Pogorelec, 2005, pp.22-24

<sup>84</sup> Balázs Egert et al. (2004), pp 58-60

<sup>85</sup> Aguiar and Martins (2005), p.226

<sup>86</sup> Trichet, 24 June 2005, Speech to ZEW, Mannheim

euro-zone. The major target concerning the low inflation rate remains unchanged. Therefore, the studies concerning the strategic directions of the monetary policy in the euro-zone do not imply major strategy changes. However, this target is not referring to the inflation level on the very short term, which could be affected by unpredictable events, but on the medium term.

Economic evolutions in the euro-zone during the last years have raised many questions concerning the degree the Maastricht criteria and the stipulations in the Stability and Growth Pact are applicable. Finding a better equilibrium between ‘*rules and discretion*’<sup>87</sup>, between the rigid level of criteria and a certain flexibility seems to be the wisest orientation not only because the countries already inside the euro-zone often face difficulties in meeting these rules (see, the almost chronic budget deficit of more than 3% of GDP in Germany), but because the future new EMU members will bring various particular economic situations.

Related to the above mentioned, one question that arises is: what is going to happen with the Community Monetary Policy when new members will accede into this area, and the homogeneity degree will decrease more, even if the nominal convergence criteria are fulfilled? Certainly, the future EMU members, who are initially the countries that have entered the EU on May 1st, 2004, will be subject to certain asymmetric shocks<sup>88</sup>. According to Mundell’s theory regarding the optimum currency area, these countries have to pursue research on the shock nature in order to decide about the most appropriate measures of economic policy, in the absence of exchange rate instrument.

Certain adjustments in the UE economic policies, including the monetary policy, are needed because of enlargement<sup>89</sup>. The explanation stands in the fact that, in spite of relatively low shares of the new countries’ GDP in the euro-zone’s GDP, the level of heterogeneity will increase, since the new members are going to register a relatively higher level on inflation (Balassa-Samuelson effect)<sup>90</sup>. In these new circumstances, the ECB intends to improve its forecasts regarding the evolution of the inflation in the euro-zone, in order to better found its decisions on interest rates.

There are also opinions suggesting that the ECB would probably need to adjust its decision making process because of enlargement<sup>91</sup>. The system includes now a number of 12 governors from the relatively homogenous states, but in the future there will be another 10 (new EU members) plus 2 (the future members). Two different solutions are under examination now: the first one, to give the extended Governors Council the mandate to represent the euro-zone, not to represent each individual country that usually leads to defending national interests; the second one, changes in the criteria of designation the number of voters that should be according to the country’s economic size they are representing. This is not a technical issue, but one of political philosophy concerning the EMU significance, and it would ask for changes in several ECB statute provisions. Enforcement of transparency in the decision making process by conveying the information concerning the Council debates and concerning the members’ votes is not stipulated in the statute of the bank, but it is suggested for future examination.

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<sup>87</sup> This opinion has been presented very convincingly by Papademos in a speech to the Bank of Spain, Papademos (2004), p.7

<sup>88</sup> Lättemäe, Raoul (2003), p. 4.

<sup>89</sup> Mooij (f.a.), p. 59-64

<sup>90</sup> Genberg, 2004, p.2

<sup>91</sup> idem, pp 6-8

### **II 3 Economic policy**

Too often, during political and economic debates, the EU integration is framed as a process that overlaps with economic policy-making (while foreign policy-making, for example, is regarded as a much more independent process<sup>92</sup>). The hypothesis that there is a *road-map* covering all economic policies to be implemented by Romania is not true, as the *acquis* does not lay down criteria for a series of fundamental economic policy issues – witness the significant differences between economic policies in EU Member States and even between Euro zone countries (the most widespread debating point from this perspective being the dichotomy between the Anglo-Saxon economic model the continental one: two views on the optimal level of state involvement in the economy and the degree of social protection it should provide for). And, perhaps of even greater significance, the implementation of policies for which there exist clear guidelines is, to a large extent, at the discretion of the authorities, meaning that the outcomes are contingent not only upon the decisions in themselves but also upon the way they are carried out.

This section offers a few guiding points with respect to the basis on which economic policy should be formulated, focusing on an area that is both crucial to the stated objective of real convergence with the EU and that, at the present, is not up to EU standards: fiscal policy. It is an area in which the Romanian authorities have a significant degree of discretion and which has an impact on the economy that is impossible to overstate (for example Ireland, which is the country that is most often mentioned in the context of real convergence, has only achieved the performances that have transformed it into one of the wealthiest countries of the EU after fundamentally changing its economic policies. From this point of view, its first ten years as a Member State of the EC were, to a large extent, lost). Creating a fiscal strategy that is coherent with the desired macroeconomic environment, with the need to absorb as much of the available EU-funds as possible and that meets the requirement of sustainability, is an intricate process that entails major reforms in economic policy-making and in the way public funds are spent. The last part of the section launches a brief discussion of labour market policies and institutions, highlighting some of the opinions attracting consensus with regard to their optimality. This is particularly relevant as the current stagnation of several of the big economies of the EU is, more often than not, blamed on a rigid legal framework, especially in what employment legislation is concerned (how difficult it is for a company to lay off employees, how many quantity restrictions there are, the desirability of collective bargaining, minimum wages requirements etc) and the generosity (or lack of conditionality) of unemployment assistance.

#### ***Elements of a fiscal strategy***

Currently, in Romania, constructing the budget is a passive endeavour, in the sense that the budget is always thought of as responding to current events, without there being an analysis of neither the medium and long-term sustainability of the respective policy choices nor of the wider macroeconomic implications. There are several causes why we are lagging other European countries in implementing a more forward-looking procedure. Among them is the fact that doing so entails curtailing some of the choices of the government in power at the moment of construction. Also, it is certainly difficult to make accurate forecasts of future

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<sup>92</sup> This is probably unpopular among EU Member States, debatable from a strategic point of view but legal considering our commitments to the Union.

economic developments and a lack of experience in this field makes forecasting exercises less credible (perhaps also the effect of ‘in-house’ forecasts - made to be politically palatable but economically not very realistic). A third and very real issue with this approach is that it takes a leap of faith to believe that future lawmakers will be constrained to surrender a significant degree of discretion by abiding to an already established fiscal framework (the budget deficit, for example, being one of the key policy variables in the economy). The current government is thus at risk to see its fiscal responsibility ‘rewarded’ by election losses and subsequent governments going on spending sprees (since political and economic cycles rarely coincide, it is possible that a government practicing restraint will not see the positive outcome of its policies<sup>93</sup>). However, if responsible budgeting is somehow institutionalized – by way of establishing clear procedures for the decisional process (implying ex-ante assessments of likely outcomes, other than future budgetary revenues), by way of external constraints such as those required by the EU and by making both the public and policy-makers aware of the future costs of current decisions – then the risk of diverging from a reasonably responsible path is minimized.

This sub-chapter of the paper is intended as a stepping-stone for constructing a medium and long-term fiscal strategy based on best practices. It outlines the stages of the process, starting with the need to establish the target of the authorities in terms of budget deficit. “Starting” is perhaps a misnomer in this context, since obtaining a figure for a budget deficit path supposes a prior analysis of current account developments and, implicitly, a sustainable path for external debt. Targeting a budget deficit strictly on fiscal sustainability criteria without regard for external sustainability is ill-advised since external balance developments can throw even the most carefully planned scenario off-track, with potentially dire consequences for the economy. Once the constraints on the budget deficit from the part of the external sector are made clear, the analysis should turn towards additional constraints such as EU-imposed medium term budgetary objectives (MTO), the Maastricht public debt criteria and indirect limits implied by the need to comply with the Maastricht inflation and long-term interest rates criteria. As will be argued, it is unlikely that the latter will exert a higher pressure on the deficit (in the sense of warranting a lower deficit) than external balance considerations, mainly because the changes to the Stability and Growth Pact that are in the pipelines<sup>94</sup> are likely to enable a country such as Romania (a high-growth, low-debt country) to run *structural* deficits. The analysis is thus intended as a brief ‘how-to’ guide to elaborating a fiscal strategy.

### **Determining external sustainability**

From an accounting point of view the current account deficit is the difference between what the private and public sector save and what they invest. There are bookshelves of literature arguing about whether a deficit in the private sector savings-investment balance warrants corrective measures from the part of the authorities. In the very brief, the debate centers on (i) whether the deficit is an outcome of inter-temporal, optimizing decisions of individual agents in the vein of Obstfeld and Rogoff (1996), in this case not requiring policy changes or (ii) if it is the result of fiscal imbalances or market distortions requiring macro-stabilization policies, the latter framework stressing the sensitivity to changes in market

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<sup>93</sup> A crucial part of this discussion is the issue of expansionary fiscal contractions, to be touched upon later in the paper.

<sup>94</sup> “Necessary improvement of the Stability and Growth Pact “  
<http://www.europa.eu.int/scadplus/leg/en/lvb/l25067.htm>

sentiment and brutal consequences thereof. It is clear that by advocating the setting of a budget deficit target partly on the grounds of facilitating external sustainability, this paper falls squarely in the second category. However, by taking into account country-specific features and admitting the possibility that persistent current account deficits can be the result of solid underlying fundamentals, the differences between the two approaches are much less clear.

The sustainable level of foreign debt, as accepted by the IMF is around 40% of GDP (a foreign debt level in excess of this threshold implies a default risk of 15-20 percent). The sustainable current account path is thus one that stabilizes foreign debt at a level below the above mentioned benchmark. It is determined by:

- Initial level of debt (the higher it is, the lesser scope for running deficits);
- Interest rates on servicing foreign debt;
- Nominal domestic and foreign interest rates. A high interest rate differential leads to high capital inflows, the resulting liquidity fuelling demand;
- GDP growth rate and type of growth (i.e. consumption driven, export driven etc). If the growth rate of the economy is higher than the interest rate on the debt then, absent further deficits, the weight of foreign debt in GDP will gradually decrease. More often, to keep the weight constant, a country can run a current account deficit equal to:  
–  $(\text{interest rate} - \text{growth rate}) \times \text{stock of debt} / \text{GDP}$ . Also, a positive productivity shocks increases the sustainable current account deficit (as it alters expected future growth);
- Exchange rate developments. From an accounting point of view, depreciation increases the weight of foreign debt, and vice versa. The exchange rate however also acts as a determinant of the current account outcome, an appreciation in excess of productivity gains, for example, leading to a loss in competitiveness. The result is contingent on the type of exports of the country in question (for example, exporters for highly substitutable goods are most sensitive to exchange rate developments);
- Type of financing of current account deficit. The larger the non-debt creating inflows (the capital account balancing item) - meaning FDI and EU funds - the higher the sustainable deficit.
- Real interest rates. The real interest rate elasticity of savings is a determinant of consumption decisions of agents. The lower the return, the lower the savings (and the higher the deficit).
- Previous investments in export sector and their ‘maturity’ profile.
- Budget deficit (in the sense that it ‘causes’ increased private sector spending), unless Ricardian equivalence prevails.

Under relatively optimistic assumptions regarding GDP growth, world interest rates and non-debt-creating inflows, Romania will need, in the medium term, to substantially decrease its current account deficit in order to stabilize the external debt/GDP ratio at the benchmark level of 40% (or compensate for it by public saving). The larger the current account deficit, the tighter the constraint on the public sector to run budget surpluses to keep the level of the debt relative to GDP constant. It is true that as opposed to that of other emerging markets, which are generally prone to more extreme output variability than

developed countries, Romania's relationship with capital markets might be facilitated because of the future EU membership. Accordingly, market sentiment may be more resilient and less likely to penalize it for amassing debt at a breakneck pace (the witnessed low spread of bonds of Italy and Greece over those of countries that have their fiscal house in order comes in support of the above assumption). However, we have not adopted the euro yet and while there exists a financing facility for Member States (that have not adopted the euro) experiencing balance of payments difficulties, it is an unenviable position to be in (the drag of a too high a stock of debt on growth) and could be subject to conditions such as an assessment of the appropriateness of prior fiscal policies.

### **Spending requirements**

At the moment there is a debate in Romania on the level of government revenues. Against the backdrop of a new fiscal philosophy, the Stand-by Agreement with the IMF was thrown off-track. This is not due to the fact that the changes enacted in 2005 have led to an increased budget deficit (on the contrary, it will be smaller than initially established in the 2005 budget) but because the introduction of the flat tax has structurally weakened the budgetary revenues, VAT revenue taking the place of income tax revenue. The agreement with the IMF will be renegotiated at the end of January 2006, and two of the conditions for continuing it are improving the structural position of the budget and creating a medium term fiscal strategy.

One point of view in the debate on Romanian fiscal issues is that we cannot afford a desirable path for EU integration given our low level of budgetary revenues (revenues, measured as a ratio of GDP, were below 30% in 2004, significantly below the EU average). In fact, this aspect mainly concerns the level of budgetary expenditures, but as the macroeconomic variable "budgetary deficit" cannot be discretionary set by the Romanian government – besides the constraints implied by debt sustainability criteria, it was subject to an IMF agreement and it will subsequently be limited by the Stability and Growth Pact provisions – the discussion focuses on budget revenues. From this perspective, EU integration is expensive given the possibility to attract co-financing from the EU (we risk to lose the funds if we do not find financial resources to cover our contributions) and because of the explicit or implicit requirements for alignment with a number of European standards (environment, infrastructure etc). Romania will inevitably have to prioritize among projects, since its capital spending needs and upgrading of public services are such that they will have to be satisfied over a longer period of time (most likely decades). However, a few of the spending items are not (entirely) discretionary and will have to be met regardless of political will. This applies to the contribution to the EU budget and, to a lesser extent, to committed EU-funds (these are intended to co-finance, together with Romanian capital, various projects). Estimating the impact of the latter on the budget is not straightforward, for several reasons: it is unclear how much of the assigned capital Romania will be able to absorb and, also, it is unclear whether or not planned spending can be financed by reallocating some of the current expenditure (as recent budgets have been quite generous with capital spending, historically speaking<sup>95</sup>). Once the above-mentioned prioritization has been realized, it remains to be seen whether or not the revenue covers planned spending. In order for Romania to make the most of EU accession, the government will have to choose between increasing taxes in order to cover these expenses, to change the expenditures structure (including efforts to raise the efficiency level of expenditures) or a combination of the two. More specifically:

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<sup>95</sup> We owe this observation to Amalia Fugaru.

a) *Performing expenditure reviews to assess the efficiency of previous expenditure.* If found lacking, expenditure can either be reallocated to areas in which public funding has had higher returns (in terms of public welfare) or disbursed on different criteria. Continuing to finance sectors that have historically not shown improved results in spite of investments (or to fund authorities that cannot account for the expenditure, in a proper manner) without conditioning the funds on a better performance amounts to throwing good money after bad. At the most recent IMF gathering of the countries in the Dutch constituency (of which Romania is a member) the managing director of the IMF, Rodrigo Rato stated that “*empirical evidence suggests that productivity of government expenditure is more important than its size in ensuring sustainable growth and development. It is essential to direct government expenditure towards uses with the highest social return*”. Thus, before envisioning a significantly greater role for the state in the economy (and raising taxes to achieve that), the authorities should have several financial exercises behind them in which 100% or close to of the expenditure is disbursed on the base of programs (as is the norm in the EU), meaning that there is a clear (and public) plan of how the allocated sums will be spent and that the authorities have information as to how effective their policies have been, enabling an analysis of future economic impact and an assessment of costs (for example, at the most basic level, the state should not pay providers of services or goods more than the private sector). Without an effective spelling out of these features, public spending is likely to remain of dubious efficiency. While it is admittedly difficult to analyze the past efficiency of public spending, there exist accepted practices to evaluate the adequacy of the results achieved with public funds. For example, given the topical subject of spending on education, an analysis comparing the performance of Romanian pupils/students given indicators such as per capita education spending and number of teachers/professors relative to other countries could ‘tell a story’ about the results of past investments in education (see an application of the production frontier approach on the Portuguese education system: Clements, 1999). Also, anecdotal evidence in this field and the institutional setup point to a poor matching between labour market needs and curricula. It should be self-evident that whatever the results of such an analysis, the public sector is not to withdraw (or even reduce its presence) in the respective fields<sup>96</sup>, merely that the approach has to be reconsidered in order to put scarce resources to the best use. Thus, each Ministry should elaborate a motivated list of priority expenditure, complete with cost-estimates and, ideally, an assessment of its capacity to manage the respective projects based on human and physical resources;

b) *Improving collection.* This has traditionally been the by rote answer of the Romanian authorities (and not only) when asked how they plan to raise additional revenue. However, as the general stance of the IMF indicates (in assessing the sustainability of fiscal policies, the Fund typically does not accept the promise of improved collection as credible since it is rarely accompanied by specific measures), significant results are not likely to be achieved passively (by cutting taxes or adjusting the legal framework without addressing the issue of enforcement). The truth however, is that there is substantial scope for improvement in this field but it requires a vigorous effort on the part of the authorities. Russia, for instance, has implemented an ample fiscal reform, which was however accompanied by vast efforts to

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<sup>96</sup> “The respective fields” are areas in which the state steps in to correct market failures or to provide services/goods to which access is not to be conditioned on personal wealth (i.e. at a price affordable to all social categories). This is not saying that all of the public expenditure in Romania qualifies under the above definition.

improve the implementation of the legal framework<sup>97</sup>. A World Bank report estimates that as much as 3% of GDP of additional revenue can be raised (over the course of several years) if the objective is pursued forcefully. While most of the discussion around this issue in Romania centers around lacking enforcement of the legislation, the role of voluntary compliance should not be understated and with it, the question of the 'return', for the individual, on taxes: witnessing positive results of public expenditure should be a catalyst for raising voluntary compliance to more European levels;

c) *Extending the tax-base.* As will be argued, some of the measures implemented by the Romanian authorities account for significant dead-weight losses (benefits accruing to non-intended recipients), meaning there is scope for raising additional revenue and improving the incentives structure of the fiscal code. Eliminating exemptions (or not introducing them, such as preferential VAT rates) is considered an element of best practices; another one is eliminating the possibility of tax arbitrage. In Romania, this occurs most frequently through the use of micro-enterprises. Prior to 2005, these were used both as a means to escape the higher income tax (as compared to the revenue tax that such entities were liable to pay) and to avoiding the social security contributions. With the introduction of the flat rate and raising the revenue tax rate to 3% (from 1,5%), the scope for evasion has been somehow reduced, however, the high level of social security contributions still provides incentives, for both employer and employee, to set up a micro-enterprise and pay fees instead of wages (i.e. avoiding social security contributions). Estimates of the likely impact on the budget of eliminating this type of evasion are above 1 percentage point of GDP<sup>98</sup> (it appears that due to an incompatibility with EU legislation, the turnover tax for micro-enterprises will be eliminated by 2007);

d) *Raising taxes.* As mentioned before, the share of budgetary revenues in Romania's GDP is often claimed as being too low, on the grounds that none of the existing or prospective members (with the exception of Lithuania) has a level of budget revenues below 35% of GDP. It may seem more relevant, however, to look at the weight of revenues in GDP when the respective countries had a similar level of GDP per capita. From OECD data (van den Noord, 2001) it becomes clear that neither Spain, nor Ireland nor Greece passed the threshold of 35% before realizing a fair bit of convergence with the older EU members (then EC). Whether it is a question of preferences or of the state's capacity to collect revenue and redistribute it efficiently<sup>99</sup>, in a way that makes an important contribution to both growth and social stability, is a matter of debate, but given the current state of public finance policy-making it is undesirable to force an even higher share of the budget in GDP. Particularly encouraging with regard to the need for a responsible fiscal policy are the results of Alesina and Perotti (1996) showing that fiscal contractions can be expansionary depending on the type of adjustment (it is shown that through the effect on unit labour costs, a fiscal contraction realized through expenditure cuts can be expansionary). Even given the above, some tax increases might have to be implemented anyway to make room for reductions in social security contributions, which are arguably too high in Romania (in Romania, tax cuts are often advocated on the grounds of promoting FDI. Authorities have, so far, been disinclined

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<sup>97</sup> An IMF paper (2005) disputes the causal relationship between fiscal reform and increased budgetary revenues in Russia.

<sup>98</sup> Gabriel Biris, "Propuneri de modificare a Codului Fiscal", 2005

<sup>99</sup> The economic reasoning behind the observed correlation between GDP per capita and size of state is that demand for goods such as education and infrastructure services has positive income elasticity (Persson and Tabellini, 1999). It should also be positively correlated with the degree of openness of the economy, on the grounds that a large public sector should act as a buffer for external shocks).

towards reducing benefits to match tax-cuts, counting on the Laffer-curve effect on public revenue. This has led to some anomalies such as the extremely high level of social security-contributions compared to other tax burdens). Raising taxes is particularly complicated as the gains in terms of revenue will have to be weighted against the losses in terms of economic efficiency and competitiveness (regarding competitiveness, tax policy will be the more important after euro adoption since monetary policy will no longer be tailored for Romania). In this respect the experience of other EU countries and in particular the so-called cohesion countries (Greece, Ireland, Portugal and Spain) is an important guide. Ireland, for example, used fiscal policy (tax cuts) as a means to attract investors as wages grew to levels where they were no longer particularly attractive (the example of past convergence stories and its relevance for formulating tax policy though, will have to be judged in the context of increased capital and labour mobility). Another matter to be considered is the ex-ante evaluation of raising taxes. If budgetary revenue is found to be lacking, the right approach would seem to also take into consideration wider macroeconomic aspects rather than find easy-to-collect from tax bases. For example, Romania clearly has a savings problem, which is reflected in its comparatively big current account deficit. Savings are a determinant of growth – being the source of investments – and a sizeable drop in the domestic savings rate, if it occurs, poses question as to how long we will be able to finance investments out of foreign savings (capital inflows). Therefore, the macroeconomic sense of a measure like the recent tax on interest income is doubtful (unless a previous analysis, of which the author is not aware, of savings' interest rate sensitivity has rejected the possibility of a drop in the savings rate).

A last point on this subject is the issue of the need for increased transparency and accountability. Implementing a variant of a fiscal rule (which range from the quite general to the very constraining) in Romania could be useful in promoting a more transparent and responsible process. The introduction of more or less stringent rules, by definition, clashes with the need for flexibility in policy-making and responding to economic realities, however, research (Kopits, IMF 2001) suggests that all but the most developed countries (in which authorities already have established their credibility and have an ingrained adequate institutional procedure for fiscal policy) can reap net benefits from committing to transparency and a fiscal rule (this is similar, in many respects, to the arguments in favour of inflation targeting).

It should be clear from the above that the authorities cannot simply look at the current level of public debt, which appears to be relatively innocuous, and assume that an increased debt is affordable, regardless of the current account deficit (created mostly by private debt) or of what a current decision means in terms of future deficits. Besides increasing the stock of debt and adding to the 'resource gap' – the amount of future surpluses necessary to service the debt (the sum of the trade and budget surplus) – increased spending or tax cuts are notoriously difficult to reverse. The theoretical underpinnings of the concept of sustainability – i.e. that a country always can service its debt as long as the present value of future surpluses equals or is larger than the stock of debt - is extremely generous and unrealistic, practically it means no more than that at some point in the future the country will have to run surpluses (cut spending, increase taxes, tighten the proverbial belt). The practical concept of sustainability however involves assessing the likelihood of such an adjustment, mainly from a historical point of view (i.e. how often has the country in question had surpluses and of what magnitude, what are the governments' tax-collecting capabilities etc). Thus, if Romania accumulates a level of debt that will take decades of 1-2 percentage points of budget surpluses only to stabilize, is this a likely and desirable policy outcome or is it 'safer' not to reach that

stage? Furthermore, what does this level of debt mean for economic growth? If a sizeable share of GDP has to be used to service debt, what is the effect on investments and on future growth? Given that, subject to some qualifications, EU accession is at the root of the need for increased spending, there is the option of postponing that kind of expenditure. However, under the N+2 rule Romania can lose valuable resources in terms of co-financing. Another aspect that the authorities have to take into consideration is the effect of the significant resource transfers on the capital and current account, and ensure that the supply-side effects of the transfers are going to prevail over the negative impact on external balances and price stability. It would be a sad story indeed if the chief effect of EU funds would be higher labour costs and inflationary pressures.

### ***Labour market policies***

Labour market policies have received increased attention over the recent decades, most of it spurred on by the higher observed level of (what appears to be) equilibrium unemployment in Europe. The different institutional setups within the EU as well as the differences between the EU and the United States have been analyzed with the intention of identifying the relative merits of the various labour market institutions as to labour market performance. As synthesized in a recent paper by Blanchard, drawing upon his own and the work of numerous other researchers (NBER 2005), one of the most celebrated strands of research is that of the effects of collective bargaining on unemployment, this framework being used to explain the observed persistence of unemployment in some European countries (the mechanism through which unionization influences the labour market is: the unions assign a lower weight to the employment of the already unemployed in comparison with its own members – the so-called insider effects - and set a nominal wage higher than the one that would have prevailed without collective bargaining resulting in some degree of persistence of unemployment). Calmfors and Driffill (1988) found evidence of the impact of the degree of centralization of wage bargaining on economic growth in the sense that the two extremes of highly centralized bargaining (of which the Scandinavian countries with their national, trilateral discussions and negotiations are the prime example) respectively the decentralized system of which the US is a good representative, have performed best, with the countries in the middle experiencing the worst outcomes in terms of unemployment and social unrest.

Assessing the importance of the above for Romania, it is difficult to believe that adopting the Scandinavian framework would have the same results here. The Scandinavian labour market institutions trace back to the 1930's, thus implying a historical legacy that would be difficult to replace by rules (the existence of mutual trust between the participants, the state's credibility as an honest broker, and so on). In this respect, Romania may have more to learn from Ireland, which championed national agreements hailed as success. However, as presented by Blanchard, there are very few opinions that gather a consensus, the most important being that unemployment benefits should be conditional on the willingness of the unemployed to accept jobs and that the authorities should reduce social contributions paid by firms at the low wage end (in general, it is considered preferable to provide incentives to low skill workers through a negative income tax rather than a minimum wage). Bertola (2004), focusing on the scope for labour market reform in EU countries, points to an inconsistency limiting the possibility of reaching an efficient outcome: mirroring the 'impossible trinity' of monetary policy-making, he states that there is an inherent conflict between free mobility of goods and factors, local decision-making powers in the labour market and social protection area, and social inclusion. Without going through the pros and cons (and constraints) of the

possible combination of the three, suffice to say that there appears to be a preference, among European countries, for not abandoning or even substantially weakening the effective social policy intervention, meaning that either there will be a backlash against economic integration, deregulation and dismantling of barriers or an agreement will have to be reached for a EU-wide social configuration.

#### **II 4 Defence and security policy**

The unprecedented time of peace and stability Europe has been enjoying at the end of the 20th century and the beginning of the 21st has been made possible by the existence of the European Union. The EU has brought about not only a high level of economic prosperity on the continent but also a new approach in security issues, based on peaceful resolution of crises and on multilateral international cooperation within the framework of common institutions<sup>100</sup>.

In contrast to these positive evolutions in the Western part of the continent, in other parts of Europe and especially in the Balkans a series of crises occurred after 1990 in the context of the geopolitical rearrangements following the end of the Cold War. An essential feature of these crises was that they were taking place more often within states than among them. European armed forces were sent abroad – including in regions such as Afghanistan, the Democratic Republic of Congo or East Timor<sup>101</sup>.

The first stage in the project of a common European defence began with the signing of the Treaty for Collective Defence in Brussels by five western European countries: France, Great Britain, Belgium, Luxemburg and the Netherlands, on March 17, 1948. However, the subsequent development of the initiative was influenced and even shaped to a considerable extent by the founding of NATO on April 4, 1949<sup>102</sup>.

At the beginning of the 1950's, the US established a plan for the re-arming of the Federal Republic of Germany, which roused the strong opposition of France. In order to avert fears of restoring the German army only years after the end of the second World War and to strongly connect the re-arming of F.R. of Germany to the building of an integrated Europe, France presented a counter-plan to the American initiative in October 1950: the Pleven Plan; it proposed the establishment of a European Defence Community (EDC). At the same time, in September 1952, negotiations were initiated for the implementation of Art. 38 of EDC Treaty, which emphasised the necessity of a robust democratic control on this Community. This would have developed into a European Political Community based on a system of institutions for joint decision-making.

If the two foreseen Communities would have come into operation, the European integration would have been close to reaching the state of confederation. But on August 30 1954, the National Assembly of France (the French Parliament) refused to ratify the treaty

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<sup>100</sup>Javier Solana, *A Secure Europe in a Better World*, Thessaloniki European Council, June 20, 2003, la <http://www.eu.int./oressdata/EN/reports/76255.pdf>.

<sup>101</sup>Liviu Mureşan, Adrian Pop, Florin Bonciu, *The European Security And Defence Policy – A factor of influence on the actions of Romania in the field of security and defence*, research paper, The European Institute Of Romania, Bucureşti, 2004, pg. 9 ff.

<sup>102</sup>Liviu Mureşan, Adrian Pop, Florin Bonciu, *op.cit.*, pg. 19 ff.

instituting the European Defence Community, therefore causing both projects to become obsolete<sup>103</sup>.

Subsequently, on October 23 1954, following the conclusion of the Paris Agreements which modified the Treaty of Brussels so as to allow Federal Germany to participate in NATO under conditions acceptable to its neighbours, two more western-European states, former enemies during the Second World war joined the five signatories of the Treaty of Brussels: Italy and Federal Germany. The new organisation was named the Western Europe Union (WEU).

The declaration of the WEU Summit in Rome confirm the will of the seven members of WEU to cooperate inside the organization through the harmonization of different points of view on specific problems related to the European security. The European Single Act from 1986 re-launched the WEU.

In the first draft, the Concept of European Security and Defence Identity (ESDI) was explicitly presented through putting together to the security and defence the concept of European Identity such as it was structured in para. 14 of the Document on the European Identity published in Copenhagen in December 14, 1973.

A series of developments marked the process of consolidation of WEU in the first half of the 1990's: the accession of Spain and Portugal (in 1990) and Greece (in 1992); the integration, as associate members in the WEU Council, of Iceland, Norway and Turkey; the founding, under French initiative, of several permanent institutional structures: the Military Committee, the Institute for Security Studies in Paris (1990), the Satellite Centre at Torrejon (1991), the Planning Cell (1992), Western European Armaments Group (1992) and the Situation Centre (1995); the setting up of European multinational forces: EUROCORP (the European Corp), EUROFOR (the European Land Force), EUROMARFOR (European Maritime Force), the European Aerial Group, the Central Multinational Division, the British – Dutch Amphibian Force and others.<sup>104</sup>

The European Defence and Security Identity has evolved in close connection with two other concepts which developed later on: firstly, the Common Foreign and Security Policy (CFSP) which holds a separate title (Title V) in the Treaty of Maastricht and constitutes one of the three pillars of the European construction; and secondly, the European Security and Defence Policy (ESDP) or, respectively, the Common European Security and Defence Policy (CESDP) which is an intrinsic part of CFSP and has been gaining in importance in recent years.

A whole series of joint institutions is involved in the CFSP decision-making process: the European Council, the Council of the European Union, the European Commission (especially the Foreign Affairs Commissioner), the European Parliament, the Presidency, member states, the General Secretariat of the Council headed by the High Representative for CFSP ("Mister CFSP"), special envoys, the Committee of the Permanent

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<sup>103</sup> Charlotte Bretherton and John Vogler, *The European Union as a Global Actor*, Routledge, London and New York, 1999, p. 200. See, also, Vitaly Zhurkin, *European Security and Defence Policy: Past, Present and Probable Future*, la <http://www.iip.at/publications/ps/0303zhurkin.html> and *New Historical Literature: European Defence Community, European Political Economy and the Beyen Plan (1950-1954)*.

<sup>104</sup> J. Bryan Collester, "Cum s-a strecurat apărarea in PESC: Uniunea Europei Occidentale (UEO) și identitatea apărării și securității europene (IASE)", in Maria Green Cowles and Michael Smith, *Starea Uniunii Europene: Risc, reformă, rezistență, relansare*, Vol.5, CLUB EUROPA, 2002, p. 391. See also Giuseppe Spinelli, „EUROFOR. Una nuova forza per l'Europa”, in *Rivista Militare*, no. 3/1997, p. 57.

Representatives(COREPER), the Political Committee, the Unit for Political Strategy and Early Warning – subordinate to the General Secretariat of the Council.

The Concept of European Security and Defence Policy (ESDP) was formulated at the European Council in Köln (June 1999), immediately after the conflict in Kosovo and subsequent to the French – British agreement at St. Malo (December 1998); it gained further value by the EC decisions. Essentially, ESDP has as its prime objective the development of an autonomous capacity of decision-making and, in case NATO as a whole is not engaged, the launching and coordination of military operations under EU authority in answer to crises; underlying the commitment of resources by member states in such operations are sovereign decisions. In this context it is important to emphasise that ESDP functions as an intergovernmental process, its political control being exercised by the heads of state and governments of member states and the financial control, by national Parliaments.

Starting from the EC reunion in Helsinki, the question of EU institutional capabilities for facilitation of decision-making was addressed and member states reached an agreement for setting up several political and military permanent bodies – the Political and Security Committee, the Military Committee and the Military Staff. The institutionalisation of activities in conflict prevention, consolidation of peace and the internal stability of states, areas or regions in crisis or threatened by crisis was achieved by the establishment, before the la Feira Summit, of the Committee for Civil Aspects of Crisis Management as the fourth permanent ESDP structure. The CACM submits information, recommendations and opinions to the Political and Security Committee.

Undoubtedly, the initiative of the four nations attempted to correct some of the deficiencies of the CFSP which had long been signalled by political-military analysts on both sides of the Atlantic. However, the announced intention to create a separate centre for planning EU operations marked a “passing of the Rubicon” regarding the tacit understanding which had existed for almost half a century that economic and political integration may take place in Europe but security would remain a transatlantic issue; this understanding was now broken.

In the Draft Treaty therefore, the new concept of CSDP replaces the former concept of European Security and Defence Policy (ESDP) and its “expanded” version – the Common European Security and Defence Policy (CESDP). The Draft Treaty establishing a Constitution for Europe assigns a special Title (Title V) to the foreign relations of the European Union. These include a series of interdependent elements such as: the common trade policy; the common Foreign Affairs policy; the Common Security and Defence Policy; development of cooperation; humanitarian aid<sup>105</sup>. Within each of these components, the main objectives of the external actions of the EU respect two fundamental principles:

The external actions must be guided by the principles which governed the founding, evolution and expansion of the European Union;

The external actions must seek to maximise cooperation among member states in all fields of international relations.

The capacity to act in a Union of 25, 27 or more states will depend to a great extent on the ability of the political leadership to define strategic goals and to promote their implementation within the current policy-making mechanisms. From this point of view, the

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<sup>105</sup> *The Future of Europe – debate, Title V: External Action of the Union*, European Commission, General Secretariat, Document TF-AU/3, 2003.

Draft Treaty establishing a Constitution for Europe makes clear progress by instituting the permanent positions of President of the European Council and Minister of Foreign Affairs of the EU.

Recent experience proves that no one state, not even a superpower like USA, can address the global security problem by itself. The international security environment experienced a dramatic change after the terrorist attacks from September 11, 2001. New relationship between the US and Russia, on the one hand, and between NATO and European Union, on the other, are making the international security environment new partnerships, but also new tensions. Under these circumstances, a lack of time, money, vision or political will, could affect not only national but also international security<sup>106</sup>.

In this context, mainly after 1998, the European Union has given a new impetus to the efforts to strengthen the security and the defining process of the European defence. The development of a Common Foreign and Security Policy (CFSP) included also the idea of the definition of a common defence policy such as mentioned explicitly in the Amsterdam Treaty.

At the same time, EU proved to be more than preoccupied by the finalizing of its own institutional reforms, especially regarding enlargements, as well as the concluding of the details on the political architecture that will define the future of Europe. The debates, at least those dedicated to the constitutional Treaty have reasonable chances of being taken up again after the negotiations in France and the Netherlands as well as after the Summit in Brussels (June 2005).

Starting with May 1, 2004, the European Union defines itself a Union of 25 States reuniting about 450 millions people, producing approx 25% of the global GDP. Being a global economic actor the European Union will have to participate more substantially in the mechanisms for ensuring the global security even if the concrete forms of this involvement are not yet clearly specified.

For all practical purposes, the players with global impact on security at the beginning of the 21st century are the United States, Europe, Russia, China and Japan. An interesting perspective is that of Zbigniew Brzezinski in whose opinion the essence of the new world security structure lies in the relation between the US and Eurasia (which comprises, beside Europe, all the other countries mentioned above)<sup>107</sup>. Within this relation two triangles of Eurasian power can be identified: US, Europe, Russia; US, China, Japan.

In response to the US hegemony there have appeared new combinations based on geopolitical interests, access to the energy sources, nuclear technologies, spatial activities, critical infrastructures etc. One can notice new formula: Russia – China - India; Russia – China; Russia – France<sup>108</sup> and others. The most pertinent observation concerning the two triangles of power is that, in each of them, one of the powers (Europe and Japan respectively) are clearly interested in stability and international security whereas one of the other powers (Russia and China respectively) remain open to and interested in potential geopolitical changes.

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<sup>106</sup> Liviu Muresan, *The New International Security Landscape*, in “Defense and Security Sector Governance and Reform in South East Europe: Insights and Perspectives”, Second volume: Macedonia, Moldova, Romania, edited by J. Trapans and P. Fluri, DCAF-Geneva Centre for the Democratic Control of Armed Forces, Geneva/Belgrade, 2003

<sup>107</sup> Zbigniew Brzezinski (ed.), *The Geostrategic Triad – Living with China, Europe and Russia*, The Center for Strategic and International Studies Press, The CSIS Press, Washington, DC, 2001.

<sup>108</sup> [www.tol.cz/look/TOL/article](http://www.tol.cz/look/TOL/article)

Another point of view, complementary to the previous one, considers that at the origin of the “new schism” there lies the tension developed between two “fields” of power, structured on opposing principles: on one side, the United States of America, supporting unipolarity and on the other side, the other major players in the international arena – EU, Russia, China, Japan – supporting multi-polarity<sup>109</sup>.

The decision factors, both civil and military, from the security sector are called upon to find solutions to the new challenges. The instruments, training, available funding, the inter-agency cooperation appear to be not only insufficient but sometimes also inadequate vis-à-vis to old and new risks to national and international security. We have to cope with the irreversible deteriorations of the environment, increased frequency of natural hazards new tensions due to underdevelopment on the North - South axis, a.o.<sup>110</sup>.

However, more relevant than these decisions was the presentation in Thessalonica by the High Representative for the ESDP and WEU Secretary General Javier Solana, on June 20 2003, of the document entitled “A secure Europe in a better world” which actually constituted the first draft of a strategic concept for the future expanded European Union<sup>111</sup>. The document performs an analysis of the security environment, identifies strategic objectives and proposes policies in answer to the main challenges and threats to security. In this latter category are included regional conflicts, poverty, famine, epidemics, refugees and massive migration, corruption, dictatorships, climate changes and energy dependence as well as “the new threats” represented by international terrorism, proliferation of WMD, failed states and organised crime. The strategic objectives that the Union undertakes are three: “contributing to stability and good governance in our immediate vicinity”; instituting “a new international order founded on an efficient multilateralism”; and providing an adequate response to the old and new threats. Referring to this latter issue, the document lays particular stress on the fact that “the first line of defence” will often be outside the EU and that Europeans “must be prepared to act before the occurrence of a crisis” – ideas which subscribe the European strategic concept within the logic of the pre-emptive action stated in the new National Security Strategy of the US, in September 2002, even if, unlike in the American document, the possibility of pre-emptive strike is not explicitly mentioned.

There are three strategic objectives that the EU has assumed and can use to counteract the new security threats:

- *Ensuring stability and good governance in the immediate neighbourhood.* This will imply extending the security area around Europe and seeing that the states in the region (Eastern Europe, Western Balkans, and the Mediterranean) benefit from good governance. The attainment of this goal will also require the continuation and developing of Europe’s contribution to ending the Arab – Israeli conflict.
- *The establishing of a world order based on effective multilateralism.* In a world defined by globalisation (global threats, global markets, and global mass-media), security and

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<sup>109</sup> See the Foreword by Adrian Pop to *Puteri și influențe*, Beaumarchais Center for International Research, Editura Corint, Bucharest, 2001, p. 7. and Ronald D. Asmus „Rethinking the EU: Why Washington Needs to Support European Integration” in „Survival”, Vol. 47, Nr. 3, 2005, P. 93 ff highlights that the challenges of the 21 Century, the new priorities and strategic needs contribute to USA’s being more dependent on the EU and its successes and when the US and EU cooperate they can set the global agenda.

<sup>110</sup> Liviu Muresan, *Riscuri și provocări în scenariile și strategiile ante și post Praga 2002*, în “Colocviu Strategic”, 6/iulie 2002, Academia de Înalte Studii Militare, Centrul de Studii Strategice de Securitate

<sup>111</sup> „A European strategic concept - defence aspects”, pp. 10, 12-15.

prosperity depend on the existence of an efficient multilateral system. This is why one of the main objectives of the European Union must be the development of a powerful international system supported by effective international institutions and by an international order instituted by law - first and foremost, by the principles of the United Nations Charter. The quality of the international system depends on the quality of participating governments. The best defence for European security is a world of well governed democratic states. Thus, the best means for strengthening world order are the dissemination of good governance, fighting corruption and abuses of power, instituting the rule of law and the protection of human rights. In this context, a fundamental element of the new world order is the transatlantic cooperation within NATO;

- *Preparing an answer to the classical or new threats.* This answer included the anti-terrorist measures taken after September 11 2001, supporting the non-proliferation of WMD and assisting failed or weak states in the Balkans, Afghanistan, East Timor and Africa (the Democratic Republic of Congo). Identifying solutions to the new threats must begin with considering their nature and conditions: they are often located at greater distances, are more dynamic and more complex than traditional dangers. Consequently, the lines of defence will have to be located abroad more often than not; the dynamic character will mean a shift of emphasis toward prevention of crises; complexity will require comprehensive action which will include export control, economic, political and even military pressure. The European Union has all the necessary tools for the adoption of such complex solutions.

The pursuit of the European security and defence objectives will make it necessary that privileged relations be maintained with the United States. However, at the same time the EU will have to develop cooperation with other important players in the world security. Strategic relations will be established with Russia, Japan, China, Canada and India without any of these becoming exclusive. Furthermore, the European Union will have to remain open to involvement in active partnerships with any country sharing its goals and values and ready to act in their defence. By this approach the EU can bring a major contribution to the establishing of a multilateral security system that would allow the building of a more prosperous, fairer and safer world.

### **III Strategic focus #3: Policy implications**

#### **III1 Development and competitiveness**

The time interval covered by the Lisbon Strategy (2000-2010) also includes 3-4 years of Romania's post-accession period. Therefore, for the time being, these objectives and the measures applied by the EU both at the community level and in partnership with the member states regard us only indirectly.

Even if in March 2000, when the Lisbon Agenda was launched, the program referred only to the 15 member states, more recent evaluations concerning the degree of achieving the Lisbon objectives include the new members, and also the future member states, like Romania. We refer to the evaluation made by WEF (in the 2004 Lisbon review), as well as the study regarding the Lisbon scorecard in the case of Romania<sup>112</sup>. Even if these evaluations do not follow the same methodology, they contain results that can be similarly interpreted. Thus, *the Lisbon Review 2004* follows the 8 objectives of the Lisbon Strategy and states that Romania, with a score of 3,35 points out of 7 (4,64 is Estonia's score, ranking the first position) ranks the 11<sup>th</sup> position out of 12 candidate countries/new members. The lowest scores were registered for Innovation, Research and Development (2,88), the Access to information society (2,91), and the best for Business environment for enterprises (3,65).

The Evaluation of the *Group of Applied Economics* focuses on the measurement of the scores in 5 fields of interest. In the case of Romania, the score is applied to the degree of compliance with Lisbon objectives for the 15 member states, in 2003, and not in relation with the objectives themselves. This study reveals the same lagging behind in terms of Innovation and Research, at the same level with the business environment- this finding is contradicted by more recent evaluation, including the World Bank's ones.

The assessment of the policies in the field of Research and Development, in Romania, related to Lisbon Strategy and to the objective of the 3% of the GDP for RDI,<sup>113</sup> made by a group of EU experts, from the European Commission- DG Research, revealed the following: although, Romania's efforts and commitments in this field are appreciated, big differences can be identified between Romania and the EU, more precisely, despite the great number of research centres, there is a weak participation of Universities to fundamental research and weak orientation towards R&D applied in the industry, respectively, the weak orientation towards high-tech industries. This is how we can explain the low number of own innovations. It is highly appreciated that the *National Plan for Development (2007-2013)*, which formulates objectives connected to the Lisbon strategy, respectively the *New Plan for RDI*, starting from 2005, introduces the creation of technological platforms at national level and launches the programme for the creation of *Excellence Centres*. The financial resources-in 2007, 1% of GDP and in 2010 3% of GDP are considered as insufficient for achieving the ambitious objectives of the plan, especially in terms of human resources in this field. The involvement of the private sector in supporting RDI is very weak, revealing the lack of a proper supporting policy in the field.

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<sup>112</sup> Blanke and Lopez-Carlos (2005), *The Lisbon Review 2004*; Dăianu, Daniel coord. (2004), *Romania. An Assessment of the Lisbon Scorecard*, The Group of Applied Economics, Romanian Economic Society, March 2004.

<sup>113</sup> "R&D and Innovation Policies in Romania", Report of the Policy Mix Review Team, September 2005, in *Politici în Domeniile Cercetare, Dezvoltare Tehnologică, Inovare*, <http://www.mct.ro/web/2/revista/1Politici%20CDI.ht.Ro>

Romania obviously tends to follow a traditional model of growth/development, by imitation, while the present chances for *catching-up* are very much related to the domain we perform worst, meaning innovation. Without increasing the financial resources for Education and Research (in this context, we do not discuss on the funding sources, which can be not only public funds, but also private sources, by supporting a University-business environment partnership) and without a future oriented strategy, we will certainly face stagnation, or even worse, decline, in comparison with the other EU members.

For the time being, Romania has to deal with important economic development problems, and to directly relate to the Lisbon strategy seems, obviously, unrealistic. The economic problems of a country, its priorities are different due to the development level, to the needs of that state. Romania is still in the stage in which the investors are attracted by the presence of cheap resources, and the need of investments for modernisation, especially in infrastructure, are huge, before jumping to competitiveness through innovation. However, certain evaluations in the Lisbon context are useful in order to find out where Romania is positioned, at a specific moment, compared to the present and future EU members, but also for taking over some orientations in the field, according to the new governance philosophy. The fact that we are, at a certain distance, behind the other evaluated countries, does not mean that we shouldn't target those objectives, which can help us to make progress towards the EU direction in the field of competitiveness.

### **III2 Membership of an enlarged European economic area**

During the first decade after 1989, the countries that were recently freed from communism were transformed into (or rather, continued to be) giant economic and social laboratories, where the most important debate, with regard to economic policy, was about the speed of transition to a market-based economic model (which would, hopefully, lead to increases in living standards to a level close to that of western states). Romania opted for a gradualist reform process<sup>114</sup>; however it was not spared high inflation, lower real income or unemployment (or its "covert" alternative, subsistence agriculture). The politic decision to delay reforms in order to avoid social turmoil is, as the process spanned over a decade, an option to scatter the transition costs over a longer period and implicitly not to place the entire burden on the shoulders of the current generation (which also had to bear the costs of the communist period). This is a strictly political decision and the economists' sole contribution would be, once the priorities are set, to emphasize the costs of the chosen strategy, the advantages, prospects of success and the measures needed in order to attain the desired objectives. Basically, the political decisions to be taken after EU accession will be about the same choices concerning the advantages of some social categories/generations and their costs (even though the respective policy consequences in the context of higher living standards and lower public involvement in the economy are less dramatic).

The context in which we are going to draw some questions concerning the economic – (1) monetary and (2) fiscal) – strategy in the post-accession period consists in the following:

- The Romania accession to the EU will most probably take place at the January 1st 2007

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<sup>114</sup> This is not entirely correct, as some liberalization measures took place at a relatively quick pace, however the delay of complementary measures (for instance, soft budget constraints) canceled/diminished the positive effect of the former.

- The preparation for accession refers to the monetary policy also, even if the adhesion to the EMU will be happening at a later date, following a certain schedule:
  - The adhesion to the EMU and the euro adoption belong to the EU integration process for all the new members, and is not submitted to an option clause (opt-out), as it was the case of United Kingdom, Sweden, and Denmark
  - The adhesion conditions at the EMU are those stipulated in the Maastricht Treaty, and they refer to the nominal and real convergences (the closeness of GDP/capita, similar evolution in the business cycle). It is however a long process that is going to continue long after the adhesion (see, to this respect, the studies on the business cycle convergence in the UK and the Euro zone, published by the Bank of England)<sup>115</sup>.

### *Monetary aspects*

From the very beginning, it is important to mention that the NBR (National Bank of Romania – the Central Bank) has prepared, with all the monetary instruments, the gradual closeness to the nominal convergence and the alignment of the monetary policy to the future adhesion to the EMU.

The present monetary policy objective, decided on August 2005, which is the ‘inflation targeting’, is fully in concordance with the ECB objective and with the strategy adopted by the new EU members. The objective clearly expresses the intention to join the ERM2 in the future, and to be closer to the ECB policy concerning the low inflation rate.

Since the Romanian economy is still facing structural changes, the flexible exchange rate regime is the best option in these economic conditions. This regime facilitates the absorption of possible shocks, and allows the market to find the right level of central exchange rate for the ERM2 in the future. Still, regarding this issue, it is important to pay attention to the consequences of an unrealistic overvaluation of our currency *leu*. It means that if the exchange rate for *leu* would not be correctly related to economic fundamentals (productivity, inflation rate), there would be a strong negative impact on exports and on trade balance.

The overvaluation has anti-inflationary effect, but this effect might be seen on the short term only; on the longer term, especially after accession to the EU the inflation rate can increase again, and can even undermine the access to the ERM2. The right valuation has to be close connected to productivity increase. But this is not the result of the monetary policy only.

The objective of disinflation, and in the future of ‘targeting’ it at the level stipulated by the ECB statute, cannot be reached by monetary measures exclusively, as it also implies a good coordination with other governmental policies, especially policies in the fiscal and income fields. As previously demonstrated by the experiences from the new EU members, in order to gradually reach exchange rate stabilization, the fiscal/budget situation is very important. In Romania, the monetary policy has progressed more, while the fiscal policy was extremely fluctuating, lacking in coherence, and difficult to anticipate. Such a policy was most damaging for the business environment, even if under the IMF pressure, the budget deficit was maintained under a certain limit.

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<sup>115</sup> Bank of England, *Euro Report 2003*, [http://www.hm-treasury.gov.uk/documents/the\\_euro/assessment/report/euro\\_assess03\\_repchap1.cfm](http://www.hm-treasury.gov.uk/documents/the_euro/assessment/report/euro_assess03_repchap1.cfm)

It is clear that, without support from the fiscal policy, the objective of inflation targeting could be easily undermined. The present solution regards either consensus on the content of the fiscal reform among all the actors involved, which should guarantee stability beyond the election cycle, or to adopt a target for the inflation level within reasonable limits – a solution that was adopted by other countries too, or both. Doing so, the adjustment of the inflation target would be avoided for one entire year in the cases of new fiscal measures that would have an impact on prices (new VAT levels, excises etc.) or in cases of unpredictable events (natural disasters, oil price increases etc.). Maintaining the commitment regarding the inflation level is important for credibility. Also, good predictability on the inflation evolution would be very useful when it is about measures on the variables that have impact on the price evolution.

- *Inflation targeting* might be in conflict with high economic growth, which usually brings a strong demand pressure on prices – *overheating* - (as was for instance the case, at a certain moment, of Ireland) but also as the impact of Balassa-Samuelson effect that goes along with the productivity increase. Romania needs a high and long term economic growth, which would induce the above mention effects, and would partially undermine the objective of inflation reduction. In the same time, the negative effect of rapid increase in the internal demand through the extension of consumption credits related to GDP explains the alarming increase of current account deficit, producing chain effect on exchange rate and on prices. We may say that the monetary policy already faced a ‘demand shock’, which has been absorbed by imposing more restrictive requirements for bank credits, that has been taken by the commercial banks as an administrative interference of the Central Bank in the market mechanism. The conflict between the Central Bank and the commercial banks concerning the discouraging measures for consumption credits, especially the credits in foreign currencies, shows on one side how the Central Bank and the commercial banks objectives – even if similar on the long term - could be conflicting on the short term. This is actually one of the consequences of the delay of structural reforms in the economy, which should have contributed to the re-launch of the domestic production, capable to cover better the domestic demand for consumption goods.
- The financial market is also lagging behind, in spite of positive evolution in terms of consolidation: too few banks, too weak competition, too expensive services. Financial market consolidation in *lei* could contribute to the ‘absorption’ of excess of liquidity, even on medium and long term, and could also diminish the demand pressure on external payment balance and on prices.
- The NBR, by shifting to the *direct inflation targeting*, achieved a certain advantage in communicating its policy (avoiding sophisticated vocabulary such as monetary aggregate like M1, M2, etc.), thus, it could benefit from larger accessibility and visibility of the objective;
- Based on the findings of this research, the opinion is that the EU will promote more the subsidiarity principle in the decision making process, as the need for more decentralisation of certain policies is obvious in order to better fit the needs of the ‘new regions’. The cohesion policy – whose financial resources are limited – has to be complemented by making more active the various market components and instruments.

The idea of partnership between the Commission and the member states was particularly emphasised by the present presidency of the European Commission, who admitted that the subsidiarity should function better in the economic policy area, or, at least, in some aspects of these policies.

### ***Fiscal aspects***

EU accession implies numerous advantages however, for a country like Romania that has a lot of catching up to do compared to other member states, probably the most important factor will be the financial assistance. The amounts that we will be able to draw from the EU are conditioned by our ability to rally domestic resources, hence, the choice mentioned above arises: should we (i) reallocate existing resources for investments that are necessary to Romania and are only going to be realized with public financing (infrastructure, education to a large extent), (ii) spend as much as we can afford without potentially painful adjustments, giving up on part of the EU funds or (iii) try to achieve all the desired expenditure and implicitly hoping for a large enough and sustained economic growth so that macroeconomic developments will not become a concern (external deficit, budget deficit)?

The present paper argues for an approach that starts with building a medium term fiscal policy framework in a plausible macroeconomic environment, to the effect that it will avoid *quick fixes* that could generate economic disruptions in the future. Difficult choices in what concerns the distribution of scarce financial resources in the context of rising demands on public services, on increasing other standards (environment, infrastructure) to EU levels and financing, out of public resources, areas considered to be of strategic importance (education, research) could be facilitated by a reform of the public expenditure allocation system and by continuously evaluating the efficiency of the expenditure. If, as a last resort, a tax increase/the introduction of new taxes is considered necessary, this should only take place after a thorough investigation of its impact on business environment and on macroeconomic variables (the case of taxation of interest income and its possible consequences on saving has been mentioned earlier). Likewise, the expected gain should not be quantified in terms of a certain number of percentage points' increase in budget revenues, but in terms of the likely effect of the respective expenditure on general welfare.

The claim that Romania should reach a certain share of budgetary revenues to GDP or to allocate a certain amount to one or another economic sector, with the budgets of other EU states or the EU average as benchmark, is only valid as long as, for instance, 5 percentage points of GDP allocated to education would have the proportional effect of 5 percentage points spent in one of the older EU Member States. If this is not the case, before burdening the economy with new taxes (which do not have a less distorting effect in the Romanian economy than in other countries) we should try improving the efficiency of the current expenditure. There are legitimate reasons not to force an increase in the budget to achieve a public expenditure framework similar in structure and GDP share with that of the older Member States; as the experience of the so-called cohesion countries (Greece, Ireland, Portugal and Spain) shows that a significant rise in living standards (real convergence to EU average) preceded the growth of budgetary revenues to levels comparable to older EU Member States (the only argument against would be that at present, there is a considerably larger number of requirements of meeting certain standards and areas in which decisions are taken at EU level, than in the last decades).

During the EU accession negotiations, the ability to obtain post-accession advantages was a much emphasized aspect, being considered an indicator of how well the candidate countries knew to defend their interests. Poland was frequently mentioned as having a very good negotiating team, especially after closing the agriculture chapter. However, the current developments inside the EU and the future path of the new Member States' economic development question the real value of these achievements. Given the substantial pressures

inside the EU (and those coming from outside) to limit agriculture- related expenditure and implicitly liberalize trade of agricultural products, it seems risky to count on a considerable EU support for Romanian agricultural development. Needless to say that it is necessary for Romania to develop its rural areas but policies that lead to their urbanization and decrease of occupation in agriculture are much more realistic than policies trying to maintain a degree of occupation in agriculture of 30% of the population. It is very likely that Romania will be able to cover a niche market for agricultural products but not much more. Nostalgia for times when Romania was one of Europe's main providers of grain will not be fulfilled with EU funds, at a time when older Member States are faced with the prospects of having to reduce their support for this sector (they will be the less inclined to allocate funds to new Member States and thus enable them to compete with their own farmers).

Another sensitive issue is that of taxation. Ireland's is a textbook case among new Member States and the fact that Ireland successfully used fiscal policy to attract investments even when salaries were no longer attractive to investors is well known. The fiscal reform and the flat income tax implemented in Slovakia have launched a debate with potential consequences both in terms of the financial assistance the EU Member States are prepared to offer and in terms of the decision taking process in fiscal policy matters. There are already those voicing the opinion that, given that the new Member States can afford low tax rates, their public resources are at a satisfactory level and they could do without the EU funds. Of course, these statements were made against the backdrop of public finance difficulties in the old Member States and the discovery that it is much more difficult for them to reduce spending (especially in the field of social protection) than it is for new member states that benefit from superior economic growth rates to afford liberal economic policies and attract investments. Consequently, there is a debate concerning the establishment of a uniform corporate tax policy throughout the European Union, but it is very unlikely to go through, mostly due to the facts that (i) countries with low tax rates will oppose it (assuming they practice a low taxation in order to compensate for other shortcomings) and (ii) because introducing a unique tax level for companies among EU will only shift the problem to income taxation, social security contributions etc. The current political mood in Romania is favourable to using taxation as a means to attracting investment and stimulating economic growth, but this has been realized in the context of high growth rates that rendered the traditional trade-off with public expenditure less conspicuous. After accession, these constraints will become more noticeable and the philosophy of cutting tax rates without changes on the expenditure side will become harder to put into practice. Rethinking the public expenditure in terms of more rigorous planning, allocating funds according to performance criteria and in areas where it does not crowd out private capital can "replace" tax cuts, as it will have a positive effect on investment (for example, in areas such as improving the infrastructure, reducing bureaucracy etc.).

### **III3 Security and defence**

The External Relations (Chapter 26) and Common Foreign and Security Policy – CFSP (Chapter 27) were among the first negotiation chapters opened by Romania after the start of the accession negotiations with the European Union, on February 15, 2000. These chapters were temporarily closed in June 2000.

Romania's Position paper for Chapter 27 regarding Common Foreign and Security Policy states that: „Romania is ready to accept and to apply the European Union's *acquis* in

the field of Common Foreign and Security Policy (CFSP). The necessary structures for its implementation have been created, and Romania's foreign and security policy is based on the same principles and has the same orientation as the one promoted by the European Union"<sup>116</sup>. Taking into consideration the above mentioned facts, Romania estimates that there will be no difficulties in implementing the Common Foreign and Security Policy acquis.

The ways and means Romania can use for integrating into ESDP are multiple: periodic consulting on European security; participating to the decision making process on issues regarding the management of military and civilian aspects of the crises; involving into the current activities of the EU organisations dealing with security issues (General Affairs Council, The Policy and Security Committee, The Military Committee, The Chief of Staff, EU Security Studies Institute, etc); participation to the WEU Assembly sessions, to the sessions of the Inter-parliamentary Security and Defence Assembly; participating to the UE lead crises management exercises and operations, and others.

From a military perspective, Romania's experience as part of the Partnership for Peace can be instrumental for achieving the ESDP objectives. The relations with the WEU can also constitute an important experience asset in the ESDP implementation process. Romania can potentially constitute an important ESDP pillar in the Central and South-Eastern Europe, a fact proven by its participation to the Multinational Peace Force from South Eastern Europe (MPSEE), to the Multinational Stand-by Force High Readiness Brigade of the UN Operations (SHIRBRIG), to the Black Sea Naval Co-operation Group (BLACKSEAFOR), to the Central European Nation's Cooperation in Peace Support (CENCOOP) and to joint military units with neighbouring countries.

The participation of the Romanian army to peace support missions is another element that underlines the viability of the Romanian military organism on the international level. Starting with 1991, Romania participated to many operations of this kind, namely to IFOR/KFOR commanded by NATO in Bosnia and Herzegovina (203 militaries), ALBA and MAPE in Albania (one police officer), UNMIK in Kosovo (46 police officers, 4 civilian experts, one liaison officer). Romania is also part of the police forces missions of the European Union (EUPM) from Bosnia and Herzegovina and to the European Union's Concordia military operation in Macedonia.

From Romanian perspective, the international security environment has evolved after 1999 in the direction of increased complexity and interdependencies in international relations. As a result of this international stability cannot be conceived without multilayer cooperation within the internal community. Thus it becomes a priority to promote the dialogue within an institutional framework by enhancing the involvement of major international organizations in the defining of state of the global security<sup>117</sup>.

During the 1990's cooperation and institutionalised dialogue were particularly manifest within the following organisations:

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<sup>116</sup> Position paper Chapter 27: Common Foreign and Security Policy , in Vasile Pușcaș, *Negociind cu Uniunea Europeană*, Vol. 1: *Documente inițiale de poziție la capitolele de negociere*, Editura Economică, Bucharest, 2003, p. 796; For the English version of the document see „Romania's Position Paper Chapter 27: Common Foreign and Security Policy”, in Vasile Pușcaș, *Negotiating with the European Union*, Vol 2: *The Initial Position Papers for Chapters of Negotiation*, Edit. Economică, Bucharest, 2003, pp. 784.

<sup>117</sup> See *The National Security Strategy of Romania*, the section on the international security environment, at <http://www.mapn.ro/strategiasecuritate/strategsecuritmediul.html>.

NATO played an essential role in strengthening euro-Atlantic security after the end of the Cold War. NATO initiated and developed the political and military partnership, cooperation and consolidated dialogue with former adversaries, including Romania; it opened up the possibility of receiving new members; it substantiated its commitment for conflict prevention and crisis management, also by peace-keeping operations (e.g. in the Balkans).

UN, especially through the Security Council, proved to be an important actor in the international dialogue on global security and stability. This was reinforced by the awarding of the Nobel Peace Prize in 2001, to the United Nations Organisation and its Secretary General.

OSCE which represented the most comprehensive regional security institution (including all European states, Canada and the United States) and played an important role in promoting peace and stability, in strengthening security through cooperation and in promoting democracy and human rights throughout Europe. The contribution of OSCE contribution was particularly manifest in diplomacy, conflict prevention and post-conflict rehabilitation.

These international circumstances raise the need for new rules in international security. However, redefining those rules after the collapse of the bi-polar order poses numerous problems, not only practical but also conceptual, including for the United States currently in the position of sole super-power. These difficulties are determined by current developments such as:

- The international environment has become much more dynamic and complex than in the Cold War period;
- The lack of consensus on approaching international security created an opening for various interest groups to manifest themselves at all levels, which prevented the elaboration of consistent policies;
- Due to real-time access to information (the so-called “CNN effect”), political leaders often have to make on-the spot decisions which do not allow for proper evaluation;
- The proliferation of specialised institutions at national and international level with specific ways of approaching problems and producing fragmented analyses and decisions;
- The lack of a reasonable “security model” acceptable for the majority of countries favoured ad-hoc reactions and local, uncoordinated approaches.

At present the European Union does not seem to be threatened by classic-type conflicts consisting of armed attacks on a large scale, yet there is a whole series of other threats looming on the horizon, each of them relatively diffuse and hard to predict - which makes them even harder to thwart<sup>118</sup>. From a European point of view, there are such threats of particular concern as follows:

*International terrorism which represents a strategic menace* This new type of terrorism is tied to fundamentalist religious movements with particularly complex causes.

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<sup>118</sup> Liviu Muresan, Adrian Pop, Florin Bonciu, *op.cit.*, pg. 15 and Richard N. Haas, “Sovereignty” in “Foreign Policy” Sept. /Oct. 2005, pag. 54 which considers that in the next decades the sovereignty of states will refer less to territories and borders and more to flows of persons, ideals, goods, drugs, viruses, a.o. in relation with the new situation of nation states which will be forced to share the power with non-states actors like global and regional institutions and organizations, financial agencies, banks, but also with terrorists, criminal gangs a.o.

Beyond the immediate dangers, terrorism is threatening the very openness and tolerance specific to democratic societies.

*The proliferation of weapons of mass destruction* represents the most serious threat to the peace and security of countries and peoples. The seriousness of these risks resides in the fact that a relatively small terrorist group can, by using WMD, cause losses which previously could only have been provoked by armies of national states.

*Failed states and the growth of organised crime* In some parts of the world (Somalia, Liberia, Afghanistan, Bosnia - Herzegovina, Serbia and Montenegro, Kosovo, etc), the existence of failed states, civil conflicts and the access to weapons caused the strengthening of organised crime. These situations represent threats to security in that they support trafficking of drugs and human beings.

*Regional conflicts undermine the basis of security and stability* and create pre conditions for terrorism and organized crime as well destroying the hope and desperation which can contribute to the proliferation of WMD. Organized crime is a danger for Europe by trafficking of drugs, human beings, illegal immigration, a.o. It become obvious the nexus international terrorism and organized crime\*

As an answer to this new threat and dangers the states, mainly those with significant military potential, consider new organizing principles for the regional and global security as new peace opportunities for democracy, good governance and rule of law. ESDP is looking for a democratic legal framework. „Because is functioning in based on command, obedience and secrecy, the military logic is very different from the public and deliberative decision making that characterises democracies.<sup>119</sup>

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\* In Bucharest was established in 2000 the Regional center for Combating Transborder Crime (SECI Center) with the cooperation of 12 states from South-East Europe (Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Greece, Macedonia, Republic of Moldova, Romania, Slovenia, Serbia Montenegro, Turkey, Hungary). This Center is an operative regional partner for INTERPOL, EUROPOL, FBI, etc...

<sup>119</sup> Wolfgang Wagner: “The democratic legitimacy of European Security and Defence Policy”, Occasional papers, No. 57, Aprilie 2005, European Union Institute for Strategic Studies, Paris p. 11

## **IV Agenda of a strategic policy for Romania**

### **IV1 Interest representation**

This study emphasized the issue of organized influence on Community decisions and argued that the decisional landscape gets obscured by the ever more complex reality of representing interests. Romania is about to confront a significantly changed context as compared to that of the accession negotiations due to an ever more increased level of interdependencies among the member countries that demands a different strategic behaviour. This behaviour takes shape as evolutions unfold on three coordinates: the Community policy-making context; positioning on the defining matters of integration; and manifest aspirations relative to certain interest groups, both of countries, and of private representatives. Each level of interaction deals with distinct challenges.

*The first element of a strategy should tackle the issue of preparedness to see the Union as a composite bloc of policies subject to particular sources of influence rather than an integrating monolithic bloc.*

The continuous enlargement of the EU has made the conditions of power inside the Union ever more exposed to strategic interactions among Member Countries. The leeway left by the Treaty of Nice as to the future negotiations of adjustments in the QMV percentages and the number of commissioners is indicative of an integration domain open to formation of coalitions, the more so *ad hoc* arrangements are likely to be settled on a considerably wider scope of the Community decisions.

Romania needs to know how to anticipate new legislation and how to operate proactively to have it passed according to national priorities. The route to the legislative act has become conditional on *rules* and *practices* of decisions. From a practical and immediate point of view, the public authorities should embark on a deconstruction process of the Community policies (*who how what decides*) and mobilise the private resources to find the right channels of representation and target significant objectives of national concern. Under the circumstances of continuously strengthening of business regulations at the Community level, the involvement of private interests in the public affairs should turn out to be a current norm subject to openly scrutinized procedures.

*The second element of a strategy should tackle the issue of the future European posture of Romania as defined by such themes as the political model of governance or the dichotomy between public and private priorities in an enlarged Europe.*

The gradual development of the *acquis* has not resulted in a more homogeneous Union; the public stance within the Community decisional domain varies among the Member Countries depending on different development models, cultural traditions or regional interests. It is this very ambiguously envisioned future path of Europe which necessarily requires a definite representation of what the membership stands for.

The membership would plausibly imply defining Europe from the perspective of certain national themes, which contributed at the same time to transforming the integrating landscape into a source of growth. To evolve into an active player of the Union, Romania should rapidly find a perspective of its own, a national, coherent, identifiable posture of cultural identity. This is a necessary condition that is to be taken advantage of to the extent the national presence finds by some means a supporting role of the integration process.

*The third element of a strategy should consist in taking advantage of the existence of a space of trust among several Member Countries in favour of Romania.*

The Union edifice of national interest representation is built not only on a variety of decisional conventions and national perspectives on integration, but also alongside idiosyncratic affinities among Member Countries. According to frequent surveys of the EU population, Romania enjoys trust and has to confront distrust from the part of distinct groups of Member Countries.

Building the future European position on country branding may be part of the required strategic actions, though it will always be object of subjective appraisals and address with such an amorphous audience as the national populations can be. Proper consideration at various levels – political, cultural, and economic – of the *existing* embrace of Romanian values and images should hold instead the centre stage of strategic policy initiatives.

## **IV2 Competitive development**

Certainly, Romania registered an improvement of the business environment, even if it did not result in a better position in the rankings carried out in the field. The improvements must continue, and, to this end, a clear orientation of policies towards increasing the competitiveness is a necessary recommendation; taking into account the stage of the Romanian economy, but also the challenges of the future regarding the economic development paradigm, the following elements are useful for increasing competitiveness.

*The fourth element of a strategy is the creation of the pre-condition for increasing the competitiveness, which is, as revealed by the theory in the field, the experience of the developed countries, and the reality's logic also, the development and the modernisation of the infrastructure necessary for the investments.*

Naturally, the limited national resources can be substantially supplemented with a better accessing of resources, offered by European programs and funding from international financial institutions.

*The fifth element of a strategy consists in starting from what already exists in the economy and economic analyses, from the measurement of the economic activities and using the base of system of indicators and proceeding to elaborating a cluster map and formulating some supporting measures for the emergence of clusters.*

The industrial strategy should take into account the essential factors on which the industrial competitiveness depends on, especially the promotion of the research – development – innovation triangle, of development of competitiveness clusters creating the progress and the prosperity of the region. We believe that this is the clearest answer to the questions concerning the priorities regarding the increase of competitiveness in the case of Romania – creating the opportunities of becoming competitive in the future.

- The governmental support for scientific applied research and innovation should be more clearly oriented and should take into account the interest in promoting the competitiveness of certain clusters;
- To the extent and in the manner the legislation regarding the state aid allows, the participation of private companies for financing research projects, which contribute to the increase of competitiveness through innovation, should be encouraged, including the financial support (see the examples of France and Hungary);

- Moreover, projects aiming competitiveness development through clusters could be included in the existing financing opportunity like FP6 and to prepare projects for FP7. In the same time we can consider that the future structural funds could be accessed by projects targeting regional development through the promotion of competitiveness clusters.

### **IV3 Economic policies**

With respect to economic policies, the fact that Romania will be the member state with the lowest GDP per capita relative to the other EU states merely reinforces the need to adequately use of the financial support provided by the EU. There is a clear tendency in the EU to reduce the support for the relatively poorer member states, amplified by the increased ‘competition’ for the respective funds. We risk losing the amounts that are offered but not absorbed in the N+2 interval, this without having the certainty that, in the future, we will be able to draw upon significant EU funds to complement our own resources.

At the same time, the strategy in the post accession period has to take into account the similar requirements as for the EMU members, the experience of strategies already adopted by the countries that are preparing to enter the EMU sooner than Romania, the specific economic conditions in Romania, and also the most well founded opinions regarding the appropriate measures for accession, when the right moment comes.

*The sixth element of a strategy refers to the possibility of institutionalizing a set of best practices in the field of fiscal policy.*

The first thing that needs to be considered is the clear separation (perhaps even going to the extreme of outsourcing it from public institutions) of the process of producing macroeconomic prognosis from political influence. Given that the entire budgetary construction rests on these inputs, it is of importance that they do not represent a wish-list of the party in power at the respective moment, but a set of useful pieces of information. Secondly, the political decisions taken with regard to public revenues and expenditure have to result in more than simply adjusting the size of the deficit/surplus or the level of taxes, and explore in detail all possible alternatives, including those that require evaluating the efficiency of the planned/realized spending, the capacity of the ministries to attain the assumed objectives and the collateral effects of the proposed tax changes. And thirdly, increasing the transparency in economic policy-making and implementation (for example by publishing the results of past investments, of costs, by comparing the productivity of expenditure with that of the private sector) and perhaps establishing a set of criteria for allocating public resources (in order to render the decisions less arbitrary) could well improve on the capacity to use the budget as a means to supporting a sustainable economic development.

*The seventh element of strategy implies that the Romanian Central Bank continues the anti-inflationary policy.*

The latest ECB Report on Convergence<sup>120</sup>, the situation existing in the new member states, and opinions on the preparatory strategies for the adhesion to the ERM2 and for the

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<sup>120</sup> Tumpel-Gugerell, Gertrude (2005), “Governance and structure of European finance after EU enlargement”, speech to SUERF/UNICREDIT conference *Monetary and Financial Policies in the New Integrated Union*, ECB, 9 March 2005, [http://www.ecb.int/press/key/date/2005/html/sp050309\\_1.en.html](http://www.ecb.int/press/key/date/2005/html/sp050309_1.en.html)

Euro adoption<sup>121</sup> all these suggest that the new and future members, including Romania, have to continue the reforms in the fields such as: fiscal reform, pension reform that accompany the demographic changes in these countries also, financial market enforcement etc.

Taking into account the above-mentioned aspects, how can the Romanian monetary policy contribute to promote *welfare*? The instrument at hand is the interest rate: credits with low interest, which should encourage investments. Also, in order to continue the consolidation of the banking system, it must be gradually oriented towards the implementation of Basel II system that is undertaken by EU banks, and not only.

*The eighth element of a strategy refers to the preparation for joining the euro-zone and to giving up the instruments of the national monetary policy, processes which should be accompanied by preparation of other policies capable to absorb these shocks.*

The fact that the Romanian economy could face on a relatively long period asymmetric shocks, which could not be absorbed by the EU monetary policy and require appropriate measures, poses the following question: Which is the degree of structural similarity with the euro-zone (the validation of theory on optimum currency area)? According to the findings, what kind of asymmetric shocks (not the demand or offer shocks) would affect the Romanian economy under the existing conditions of economic structure, of trade structure and business cycle evolution? Which should be the alternative measures for this kind of shocks? Which will be the policies Romania can count on for absorbing the post-accession shocks, and moreover after joining the EMU, in order to avoid the statute of a regional loser? We think that the solution relies on flexibility: labour market flexibility, including labour force mobility, which requires adequate changes in the educational system (for instance life long learning), more diversity in the economy, not as opposite to specialization, but opposite to low number of specializations, giving up the administrative prices that distort the real image of inflation.

In the same context, it is necessary to maintain as long as possible the fiscal policy instruments that fit the Romanian economy needs, without undermining the idea of a healthy fiscal policy (budget equilibrium): the need for jobs and more work, the strong need for innovation (R&D), support for those activities for which Romania proves propensity and high potential (IT).

#### **IV4 Security and defence**

Romania is situated in Europe and will become a member of the European Union. Therefore Romania should encourage and participate to ESDP. In the field of the security and defence policy Romania should count on certitudes (the NATO member statute and the Intensified Strategic Partnership with the USA), without any ostentation or exclusive attitude in this respects<sup>122</sup>.

*The ninth element of a strategy consists by maintaining the complementarities between the two organizations in the relation NATO – EU.*

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<sup>121</sup> "Monetary Policy Council, Medium Term Strategy of Monetary Policy (1999-2003)", Poland, September 1998, the site address: : [http://www.nbp.pl/en/publikacje/o\\_polityce\\_pieniezn/strategia.pdf](http://www.nbp.pl/en/publikacje/o_polityce_pieniezn/strategia.pdf); see also Lavrač (2003), pp. 54-82; Tuma (2004), pp. 1-2

<sup>122</sup> Liviu Muresan, Adrian Pop, Florin Bonciu, *op.cit.*, pg. 97-99

The option of the majority of EU member states concerning the NATO-EU relation in the field of security and defence is maintaining complementarities. However, this will only remain an option as long as the ESDP proves able to prevent and manage crises and conflicts in the EU immediate neighbourhood.

The risk of an interest or loyalty conflict in the Romania - USA/NATO and Romania – ESDP relations is low because ESDP will not have, in the predictable future, the capability of effectively engaging in big military operations. Under these circumstances Romania could participate, for instance, to peace keeping operations within ESDP and any other type of military operations together with NATO/USA.

*The tenth element of a strategy is the new geopolitical environment which requires a proactive policy of Romania in the Black Sea area – a key area for the security of Europe, in promoting the new European Neighbourhood Policy, including the energy security of the European Union, in the prospect of the European integration of the Republic of Moldova and Ukraine and others.*

Consequently to the EU expansion after 2007, the Eastern neighbours of Romania (Ukraine, the Republic of Moldova) will become both western frontier of Russia's "near vicinity" and Eastern frontier of the "new vicinity" of the EU.

Romania can act as an active ESDP implementation factor, through the existent human and logistic resources as well as through the experience gathered in peace keeping missions and regional military co-operation; it is estimated that in 2006 a number of 2900 Romanian military will take part at combat actions as well as joint international exercises.

Romania should become firmly and clearly involved in the fight against terrorism. This position could be later on used for justifying any pronounced support of the NATO/USA pole that might not necessarily reflect the European Union's position. It is also true that under the fight against terrorism aegis Romania could develop military co-operation relations with states from other geographical areas (Japan, China, and Latin America).

Starting from the structural co-operation concept presented in the project for the European Constitution, Romania will have to identify those countries willing to assume more binding commitments. This paper considers that the consistent participation of Romania to military operations under ESDP auspices would create a favourable attitude towards Romania amongst the other European countries.

*The eleventh element of a strategy is the setting up of some national and regional structures of crisis management as well as for strategic analyses and actions.*

In order to enhance the chances for a relevant contribution to the ESDP, Romania must promote and act upon the concept of inter-agency cooperation in crisis prevention and management. Romania should support the creation of the European Agency for Armament, Research and Military Capacities (EARMCA).

Specialised departments established within the Ministry of Foreign Affairs, the Ministry of National Defence, The Ministry of Administration and Interior and others could monitor the evolutions of the ESDP and provide the necessary expertise for adequate decision-making. At the level of Government it could be also organized a Department for European and Euro – Atlantic Security and Defence Policy with the coordinating role of the specific domestic activities and as contact point for the international cooperation initiatives.

#### **IV5 Concluding remarks**

This study does not attempt to put forth an exhaustive list; a future strategy may reasonably go beyond the eleventh element, as it may focus on just one or two of them, in a so much needed strategic vision. The importance of the list, as it is suggested by the analysis, does not reside in its coverage, but in its strategic focus on several critical evolutions affecting the future position of Romania in an enlarged Europe. Whatever element of the list takes shape along three defining coordinates for strategy formulation.

Firstly, the strategy is formulated on the *power* coordinate in the sense of promoting the national interests by means of and to the benefit of the European integration process. The European Union should not be regarded as an integrationist bloc, however much legal justification this perspective would find in the founding treaties. The act of membership is important as it turns the priorities of both the public (Presidency, Parliament, and the Government) and private (businesses and non-governmental organisations) bodies from a complex and seemingly confused whole toward several distinct paths according to the way policy formulation is primarily conceived in Bucharest or abroad, in Brussels, in the decision centres of the Euro groups or in the corporate offices.

Secondly, the strategic vision is outlined along the coordinate of a *technical participation* to the European construction through Community policies. Within the present context of policy formation, Romania is likely to dismember any demarcation line between the inter-governmental negotiations and its domestic actors and support thus the setting-up of several coordinating groups with a view to advancing a national position as to the proposals of Community law and the most appropriate way of decision implementation. In their turn, the representative groups should take up the responsible task of providing reasoned opinions as regards the expected impact of the adoption of Community legislation. They should appear as a trustworthy source for recruiting a professional body of experts to represent Romania during the technical debates at the European institutions in the post-enlargement period<sup>123</sup>.

Finally, the third coordinate consists in *realistic policies* of placing the European evolutions in narrower – national and regional – or wider – global – contexts according to the interests relative to the economic development and security matters of the Romanian people. A realistic vision assumes the EU integration as the dominant process, but is not presumed to overlook the equally important fact that the evolutions of significant economic and political impact do not necessarily originate from the geographic vector spread between the Eastern and Western parts of Europe. The macroeconomic shocks are countered within rather small economic spaces that allow the entrepreneurial initiatives be optimally effective, whereas the security threats follow paths built on distinct rationales as compared to the benefits of integration.

In sum, what appears with the force of evidence consists in the necessary projection of an *economic space favourable to adaptation and flexibility*. This study points out the solution in the adaptation capability and flexibility: labour market flexibility, including labour force mobility, which requires adequate changes in the educational system (for instance, lifelong learning), more diversity in the economy, not as opposite to specialization, but opposite to a low number of specializations.

These are just several examples at hand, which apparently relegate the EU membership to secondary importance. The strategic decision is based on the priority exploit

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<sup>123</sup> The idea was suggested by Professor Mihai Korca, ASE Bucuresti.

of the membership for the very reason to enhance the capability, i.e. a larger pool of resources and increased negotiating power, of withstanding challenges that would have become effectual anyway. Romania should outline its strategy development on the prerequisite that the EU alongside its various representations (economic, political, social, and political) constitute a resource base rather than an objective or a target of the post-enlargement period.

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