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Research Report

An assessment of the recent economic, social, legislative and institutional outlook in EU new member states

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Study no. 9

**AN ASSESSMENT OF THE RECENT
ECONOMIC, SOCIAL, LEGISLATIVE AND
INSTITUTIONAL OUTLOOK IN EU NEW
MEMBER STATES**

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At the 1st of May 2004, 10 new states joined the old 15 member states of the European Union, an historical moment and a step forwards towards a future unite Europe. In the same time, the adhesion meant the peak of a whole process of economic and social transition of 8 countries from the plan economy towards a democratic, free market model associated with a modern societal development.

The economic and societal impact of the 2004 enlargement seems to be the most significant so far from all the enlargements before. The EU population grew with almost 20% reaching 460 millions inhabitants. The share of EU economy in the world economy grew as well, the contribution of the New Member States being estimated at about 10% in PPP terms.

The expectations of the experts and political decision makers concentrate on a positive development that is to take place in longer term. Even if the degree on integration between the old and the new member states was already rather high in 2004, the enlargement will have a positive impact, both through the increasing and strengthening of the Single Market and of the competitiveness of the European economy, as well as through a general development of the European multicultural area. These two dimensions will be the main lines of sustainable development for the socio-economic and cultural EU.

The current study has two sections, employing different methodology. Both sections are meant to analyse the situation and the development of the society as a whole before and after the adhesion. The first section of the study benchmarks the performance of the NMS in relation with their own objectives assumed before the integration as well as with the new overall objectives of the European Union. The analysis is constructed around the main socio, economic, politic and institutional indicators, horizontally, as comparisons between the member states. The second section describes – in the same comparative manner – the main elements of macroeconomic policy-making process before and after adhesion, as well as the risk factors therefore highlighted.

Finally, the conclusions of the study look at the effects of the integration in short, medium and long term, pointing out at the potential main macroeconomic shocks that might occur in some of the NMS as an effect of adhesion. The key findings of the study concentrate on the possible and optimal alternatives of transposing the positive lessons identified as crucial for articulating the socio-economic policies that Romania will implement in the near future.

1 Comparative analysis of pre and post accession periods from the perspective of the main economic, social, political and institutional indicators

The build-up of the EU was a long-lasting process developed during around 50 years¹. The enlargement in 2004 is the biggest so far, adding 10 new member countries to the union, from which 8 in the Central and East-European area. Bulgaria, Romania and Turkey hope to join the UE in 2007 or after. The cost of integration is estimated to € 107 billion (cca. 67 in 2000-2005²), from which € 15 billion will be covered by the NMS themselves³.

The Central and East-European countries, similarly with the Southern countries that joined the EU in previous stages, have less developed economies, but lack as well a long enough democratic tradition and face specific problems and particular features of the societal dynamics. The simultaneity of these issues put the ex-communist countries under significant strain between the needs of restructuring on the basis of market economy and of those inner to a buildup of a renewed cultural and national identity. The subsequent and often overlapping stages of this process combined with the economic and political interest on its results lead to a deepening of the debate around the transition as a part of the globalisation. An unbalance between economic and social issues marks nevertheless these debates, with most of the attention being channelled towards the economic and political development, the social aspects being often.

Moreover, one of the classical dilemmas of the transition is the understanding of the divergent convergence and the variety of the integration trajectories that these countries show.

Immediately after the fall of the Berlin Wall, the European Community established diplomatic relationships with Central and East European countries, followed up by commercial treaties and economic cooperation agreements. This chapter looks at the progress made by the NMS in the post-integration period according with three important groups of factors:

- the initial conditions
- the integration policies and negotiation strategies
- the horizon of prognosis and the strategy of integration into the euro zone

The economic and political impact of adhesion is significant. As a consequence of enlargement, the EU became the most important economic power, in terms of GDP. Nevertheless, is to be expected that the overall benefits of the integration would differ from one country to another, or from one region to another, not only quantitatively, but as well in timing and intensity. Most of the academic studies suggest the positive effect that the eastern enlargement will have on the economic growth especially through the deepening of the competition and the intensity of the activity on the financial markets. The next step in the process will be of course the adoption of the Euro, in its turn dependent on how soon the member states will achieve the nominal convergence, according to the Maastricht criteria: price stability, level of budgetary balance, participation to the exchange rate mechanism and the long-term convergence of the interest rates. These criteria are based on the consensus at the European on the fact that the stability policies create the optimal framework for economic growth and job creation.

¹ In 1957 European Community has been established having six Members, followed by enlargement rounds in 1973, 1981, 1986 and 1995. In 2003 the European Union already had 15 Members.

² <http://news.bbc.co.uk/2/hi/world/europe/2266385.stm>

³ Manning, N (2004) "Diversity and change in pre-accession Central and Eastern Europe since 1989", Journal of European Social Policy 14 (3)

From a methodological point of view, we will evaluate the progress of the Central and East European countries, EU candidates, in fulfilling the economic criteria of adhesion through the evolution of macroeconomic indicators reflecting the economic stability of a country. This analysis will be made in two distinct time frames:

- *the last 5 years previous to the enlargement (1999-2003)* for which the main weaknesses and strengths in the economic development of selected NMS are to be revealed through a comparative analysis of main macroeconomic indicators in NMS8 and UE15, with a special emphasis on the last two years prior to the integration. The analysis is performed using national statistics and EUROSTAT data.

- *the first year after the adhesion (2004)*, for which a detailed analysis of the indicators is performed and 2005 and 2006 providing forecast for both for the NMS8 as well as for UE25 as a whole.

The SWOT analysis will complement and synthesize the quantitative analysis of the NMS8 in the first year before the adhesion. As case studies, SWOT analysis will be provided for Poland, Hungary and EU 25.

1.1 Initial conditions and comparison of pre-accession strategies

The countries of Eastern Europe have been confronted for more than 14 years with a complex process consisting of internal transformations during their preparations for EU accession. On the first of May 2004, eight of those countries, Czech Republic, Slovakia, Hungary, Poland, Estonia, Latvia, Lithuania and Slovenia, have become members of European Union.

In this chapter we have made an analysis of the economic aspects of this process, in order to reveal *the economic performances of this new member states until their accession into the EU and the major changes which occurred after the accession*. We also want to reveal that the other aspects, political, social and security aspects, the cultural and ethic aspects are equally important.

For those countries, achieving economic stability and sustainable development are key factors, because the functional market economy and the ability of facing the competition on the internal market constitute an important premise of the EU accession, being the economic criterion that a candidate country must fulfill in order to become a member state (The Copenhagen Council 1993).

The first three challenges for post-Communist countries and their horizon of achievement

1. Economic stability- short term
2. Liberalization-middle term
3. Institutional reforms-long term

1.1.1 THE PROGRESS OF THE NEW EIGHT MEMBER STATES (NMS) IN ACCOMPLISHING THE ECONOMIC CRITERIA FOR THE EU ACCESSION

The progress of the eight NMS concerning the accomplishment of the economic criteria can be measured with the following economic indicators: GDP, Harmonized Index of Consumer Prices, General government financial balance. Those indicators reflect the country economic stability.

GDP

European and international picture

The beginning of the 1990s was characterized by an international unfavorable economic environment, due to the crisis of the global economy. For the very first time after 1945, the aggregated GDP at global scale had declined with 0, 4%. The recovery has begun in Europe in 1994 and, by the end of the decade, the rate of economic growth was between 2, 5% and 3, 5%, half of the one registered in 1973. After 2000, European Union was confronted with slow economic rise, 0, 9 - 1, 6%, and many annalists have considered that she was passing by an economic recession.

In Central and Eastern Europe the revolutionary changes which occurred in 1989 and in 1990 were followed by a powerful economic crisis, compared by some annalists with the Great Recession of the '30, or with the damage created by WWII.

The intensity and duration of each crisis varies from a country to another, being more accentuated in eastern countries (negative economic growth with two digits). For the majority of countries, the crisis lasted until 1994. Starting with this year, until the end of the 1990s, all eight candidate countries registered positive economic growth rates (with the exception of 1997 and 1998 when the effects of crisis from Asia and Russia were felt).

Real positive performances in all candidate countries starting with 2000

The year 2000 represents the beginning of the accelerated development of the Central and Eastern European countries (CEEC). The average growth rate of GDP in NMS-8 was double compared to 1999, reaching 4.7%. The highest rate of growth was registered in Estonia (6.9%), Latvia (6.6%) and Hungary (5.2%).

The international events in 2001 such as: the negative impact of international economic environment, the decrease with 50% of the global economic growth rate, the increase of the oil price, the impact of the 11th of September 2001 events from the USA, have also influenced in a negative way the Eastern European economies, by slowing down the economic growth trend. However, some of the candidate countries have succeeded in limiting the impact of the international events by increasing the internal economic demand.

The average economical growth percentage in 2001 was of 4.35%, with the maximum value in the Baltic States and the minimum value in Poland (1.1%), due to the lack of support from the internal economic demand.

Two years before the decision of extending the EU towards the Eastern European countries, the EU GDP increased with only 1.1%, which generated quite an unfavorable environment for general European economies. Under these circumstances, the GDP of the 8 central and eastern European countries started to increase at a slower pace. Even though in Estonia and Lithuania the economical growth was for the second consecutive time at the highest level in all Eastern European countries, this was not enough in order to compensate the unsatisfactory economic performances of the Czech Republic, Hungary and Latvia.

Export and investments were the main components of economic growth for the future eight member countries.

2003 was the year when the economic growth of the 8 new member states started to increase at an accelerated pace. The average growth of GDP was of 5.2%, disregarding the economic recession from the 15 EU members' economies. In 2003, the Baltic countries kept registering the most important economic growth rates (6.7-9.7%) of all European countries.

Investments in these countries have been the most important factor of the economic growth.

Domestic consumption wasn't a key factor in determining the economic growth, due to the fact that the control of the public finances was a must of the economic policy.

Table 1.1: The growth rate of real GDP between 1999-2003

	1999	2000	2001	2002	2003
Average of the NMS 8	2.3	4.7	4.4	4.3	5.2
EU 15	2.9	3.7	1.8	1.1	0.9
Romania	-1.2	2.1	5.7	5.0	4.9

*(constant prices 1995)

Source: Eurostat database

GDP/capita

The GDP/capita (also taking into account the purchasing power) expresses the **level reached** by a country with respect to the economic results.

The analysis of this indicator reveals on one hand, the existence of significant gaps between the candidate countries and on the other hand, between these countries and the EU members.

In the beginning of 2000, the eight candidate countries recorded low levels of GDP/capita increase, which represented, for instance, only 35% (in Latvia) and 72% (in Slovenia) of the EU 2005 average level.

The target of the candidate countries was to reach 70% from the average of EU 2005 level.

This target was not reached in 2003 with the exception of Slovenia (76%). The other countries' GDP/capita was in a range of 40% in Latvia and 68% in Czech Republic from the average of EU 2005 level.

Tabel 1.2: GDP/capita in the Eastern and Central European countries

	1999	2000	2001	2002	2003
EU25	100	100	100	100	100
EU15	110.2	110.1	110.1	109.8	109.6
Average of 8 NMS	49.5	50.0	51.5	53.0	54.6
Romania	25.6	25.2	26.5	28.5	29.5

Source: Eurostat database

In nominal terms, the data from 2003 indicated a significant growth of GDP/capita for the eight candidate countries. The average GDP/capita for the eight candidate countries was 116.614 Euro/capita (+8.5% compared to 2003). This GDP level represented 46% from the EU-15 level (25.350 Euro/capita). It can be easily observed that this level differs significantly from the target of 70%, as initially established.

The GDP/capita was not consistent for the eight candidate countries; for instance in Slovenia we had more than 80% of the EU-15 level, followed by the Czech Republic with 66% and Hungary 61%.

The GDP/capita level in each of the eight candidate countries was more than 10.000 Euros. The highest level was registered in Slovenia (20640 Euro/capita) and the lowest level was in Latvia (10.310 Euro/capita). We can notice differences between the levels of GDP/capita even between the group members, with a ratio of 1:2 in the year that preceded the EU enlargement.

Table 1.3 : GDP/capita in 2002 și 2003

	euro			
	2002	2002e*	2003p	2003e*
UE-15	23970	100,0	24450	100,0
Czech Republic	14750	61,5	15620	63,9
Estonia	10030	41,8	10880	44,5
Hungary	13720	57,2	14420	59,0
Latvia	8700	36,3	9410	38,5
Lithuania	9850	41,0	10610	43,4

Poland	10230	42,7	10780	44,0
Slovakia	11890	49,6	12680	51,9
Slovenia	18070	75,3	19190	78,5

European Commission forecast, 2003

*- author's forecast

Following the GDP/capita evolution in the eight candidate countries compared to the EU-15 members' results, it can also be observed that the gaps started to decrease after 2002.

Inflation

One of the most important and painful phenomena of the economic crises from Eastern and Central European Countries was the inflation, measured by the index of consumer prices. Obviously, inflation affected the life of the entire population from these countries in a negative way. Also, this negative impact was felt by the business environment and decreased the level of foreign investments.

According to the EU official reports, the inflation of the 15 member states started to continuously decrease in the beginning of the 90^s when the average index of consumer prices was 5%, reaching to 1.2-1.9% in 1999-2000. In 2001-2004, the inflation level slowly increased to 2%/year.

Table 1.4: Evolution of consum prices index in the 8 NMS, EU 15 și Romania, 1999-2003

	1999	2000	2001	2002	2003
Average of the 8 NMS	5.1	7.3	5.0	3.5	2.8
EU15	1.2	1.9	2.2	2.1	2.0
Romania	45.8	45.7	34.5	22.5	15.3

Source: Eurostat database

The EU performances with respect to the inflation control differed in the last ten years; however, the common trend was the decrease of the inflation level, compared to the 1990-1993 results.

In the past decade, the highest inflation rates were recorded in Lithuania (1161%) and Estonia (1076%) in 1992 and Bulgaria 1082% in 1997. The other candidate countries had either 2 digits inflation (between 11-18%), or 1 digit inflation, like the Czech Republic, Slovenia and Slovakia (lower than 10%).

Starting with 1997, the average inflation of the eight candidate countries was lower than 10% and continued to decrease with a rate of 2.8% in 2003.

Unemployment

Unemployment was a relative new phenomenon in Central and Eastern Europe, being officially recognized as such before the 1990s only in Poland (0.1%), Hungary (0.6%) and Slovenia (2.9%). Unemployment increased faster after the 90s, reaching in some country rates between 15-19% from the total level of the active population. In the Czech Republic, Estonia and Latvia, the unemployment rate was lower than 10%, due to the very poor level of incomes.

Some studies from the middle of the 1990s speak about a remarkable flexibility of the labor market, due to the fact that a lot of the employees preferred to receive low incomes rather than to loose their jobs.

The low level of unemployment can also be explained by the lack of determination in the process of changing the industry characteristics and of the delay of admitting the bankruptcy of a lot of unproductive companies.

In some candidate countries, the low level of unemployment is due to the fast development of the service sector, which has attracted an important number of persons (Czech Republic).

Unemployment decreased in 2000 and 2001 in most candidate countries, except Lithuania and Poland in 2000 and Lithuania, Poland and Slovakia in 2001. It can be observed that, in these cases, the unemployment trend is the reverse of the inflation trend.

It must be taken into account that these statistics referred only to the unemployed persons, which received social security aid and do not take into account the long term unemployment, outside of social security.

Philips' curve (reverse correlation between unemployment and inflation) was also confirmed by the EU evolution, where, in 1999, inflation has decreased and unemployment and industrial productivity have increased. In 2001 in the EU, the unemployment has decreased, reaching the average level of 7.3% of the total active population. At the same time, inflation increased from 1.9% to 2.3%.

In 2001, however, both inflation and unemployment have decreased in Hungary, Latvia and Slovakia, which represents a different evolution from the one expressed in the economic theories, raising a question mark regarding some experts' opinions, who have sustained that inflation and unemployment cannot decrease at the same time.

Comparing the eight candidate countries with EU-15, it can be stated that there is a convergent trend with respect to the unemployment evolution. In EU-15 the average unemployment rate was of 8% in 2003 and 11% in the candidate countries.

General government debt

The economic crises of 1991-1993 have determined the equilibrium break of the budgets of the majority of Eastern European countries and represented one of the constraints of their economic evolution. Since the 1994, the budget deficit started to decrease synchronously with the economic growth.

Hungary had the highest budget deficit, of 9.2% of GDP in 1994 and 7.1% of GDP in 1998. As the result of coercive economic policy, Hungary has managed to reduce the budget deficit to 2.9% of GDP. In 2000 and 2001, the budget deficit in Hungary increased again to 5% of GDP.

At the same time, Poland maintained a low level of the budget deficit during 1994-1999, but the deficit increased after to 6% of GDP in 2001.

1.1.2 ECONOMIC AND SOCIAL PERFORMANCES OF THE EASTERN AND CENTRAL EUROPEAN COUNTRIES IN THE FIRST YEAR AFTER THE ENLARGEMENT AND THE 2005-2006 FORECAST

The European experts consider the enlargement toward East of EU as a success, by determining the economic growth of the new members, as main consequence.

The economic growth can be explained by the increase of the domestic demand and by the additional foreign investments. The Western European companies still take the advantage of the cheaper markets of the new member states ("Economic Forecast Spring 2005").

GDP

2004 was the year of an important economic growth level for all the new member states, except for Lithuania, which had a record GDP growth rate of 9.7% in 2003. The experts of the EU Commission, of the ONU Economic Commission for Europe, and of E.B.R.D., noted in their studies that the economic growth of 2004 compared to 2003 is the result of the enlargement.

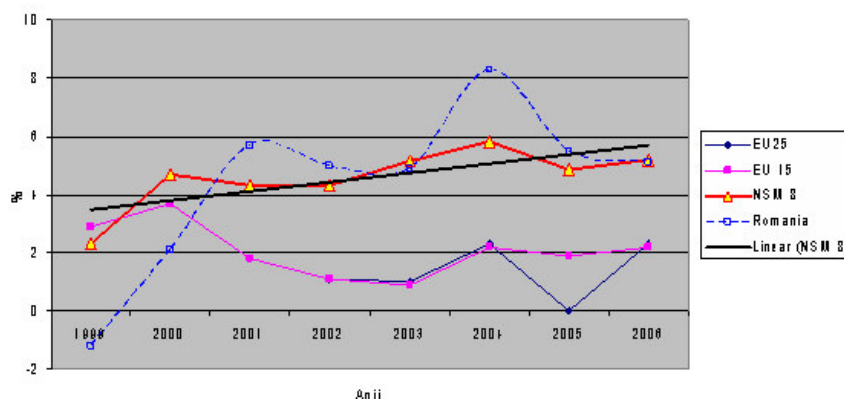
The economic growth is due to the following elements: foreign investments (as % of GDP), productivity increase, new opportunities of employment, all these constituting incentives for the improvement of life quality. In addition to this, the end of the recession for the EU members occurred in 2004 and was marked by the 2.4% economic growth rate, which positively influenced the all new member states economies (which followed the growth trend (5.8% on average)).

The foreign investment figures highly increased in 2004 in most of the countries, due to the new advantageous credit terms, additional Western European capitals and stock management policy.

The increase in investments was also due to the fiscal policy, oriented to the stimulation of company profits, encouraging those companies to reinvest the profit obtained.

FIGURE 1.1

GDP evolution between 1999-2006



Perspective 2005-2006

The dynamics of the economic growth of the new eight EU members is expected to continue 2005-2006, even though the rate will not be so spectacular, remaining at the 2004 level in Poland, Hungary, Slovakia, Slovenia, Latvia and Lithuania (European Commission). **The positive part of the evolution will be based on domestic demand** and not so much on external demand, due to the slower rate of the economic growth in the Euro zone, EU-15 and the global market.

The engine of the economic growth will be represented by the internal investments. If foreign capital will also participate to these investments, it can be assumed that the economic growth forecast is fully sustained (Albu, C. 2005).

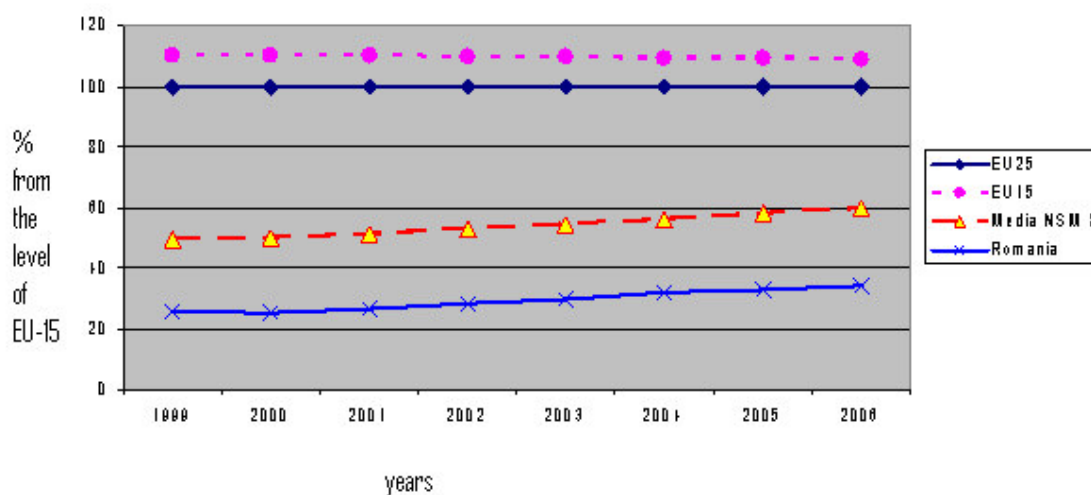
GDP/capita

2004 was the year when the target of 70% of EU-15 GDP/capita was reached by two countries: the Czech Republic and Slovenia (78%). At the same time, the EU-15 countries had the GDP/capita with 9.4% higher than EU-25. In Latvia, GDP/capita had the lowest level (43% of the EU-25 average level). For the new members, the GDP/capita increased in 2004, but the average level represented only 56% of the average level of EU-25 (54.6% in 2003).

To be noted that, all the eight members recorded a GDP/capita increase, based on their internal development.

FIGURE 1.2

The GDP/capita evolution



The forecast for 2005-2006 on GDP/capita foresees a level of 60% from the EU-25 level.

Inflation

Joining EU, the new members were forced to face the significant increase of inflation.

The rate of consumer prices of the eight new member states “exploded”, increasing in 2004 to 4.3%, more than double of the EU-15 level.

The Czech Republic had the most rapid inflation increase from -0.1% in 2003 to 2.6% in 2004, followed by Poland from 0.7% to 3.6%, Estonia from 1.4% to 3%, Latvia from 2.9% to 6.2% and Hungary from 4.7% to 6.9%. The dramatic increase of the inflation forced Slovakia and Slovenia to build special programs in order to fight inflation, which determined a slight inflation decrease.

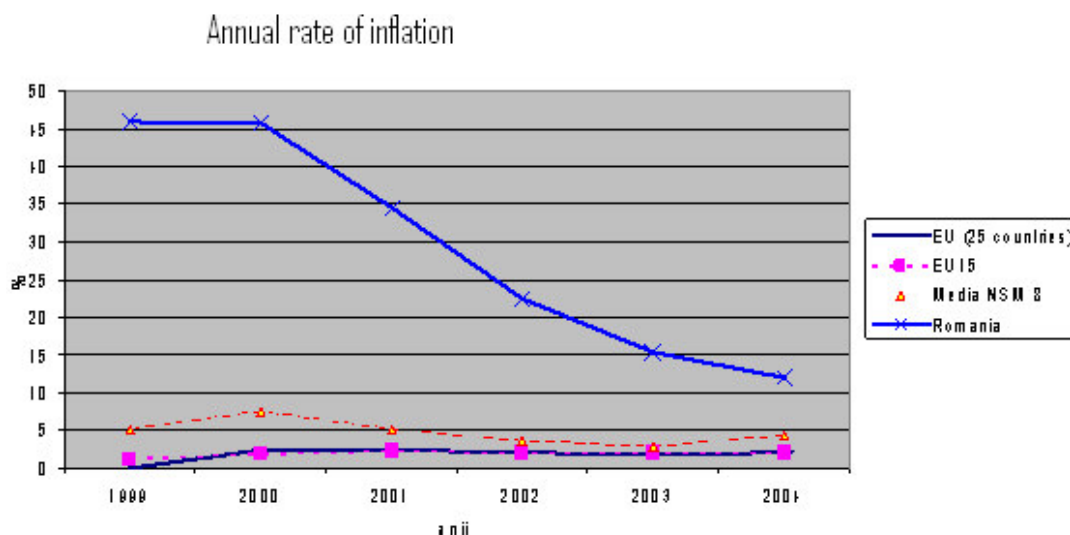
The main causes were: joining EU and the increase of the international price for oil and other natural resources. The alignment of the prices for goods and services, imposed by the EU, has also created inflation pressures that couldn't be avoided by the new member states. (Albu, Cornel, IEM 2005).

The inflation shock of joining the EU will not have such a strong impact for the new member states, except of Estonia and Lithuania, where will still continue to be significant.

The slowing down of the inflation will be mainly due to the decrease of the oil price.

Taking into account the target of adopting the single currency (Euro), the new member states governments will be forced to take actions, in order to fight inflation, in 2005 and 2006 ("Economic Forecast Spring 2005", "CE, 2005).

FIGURE 1.3

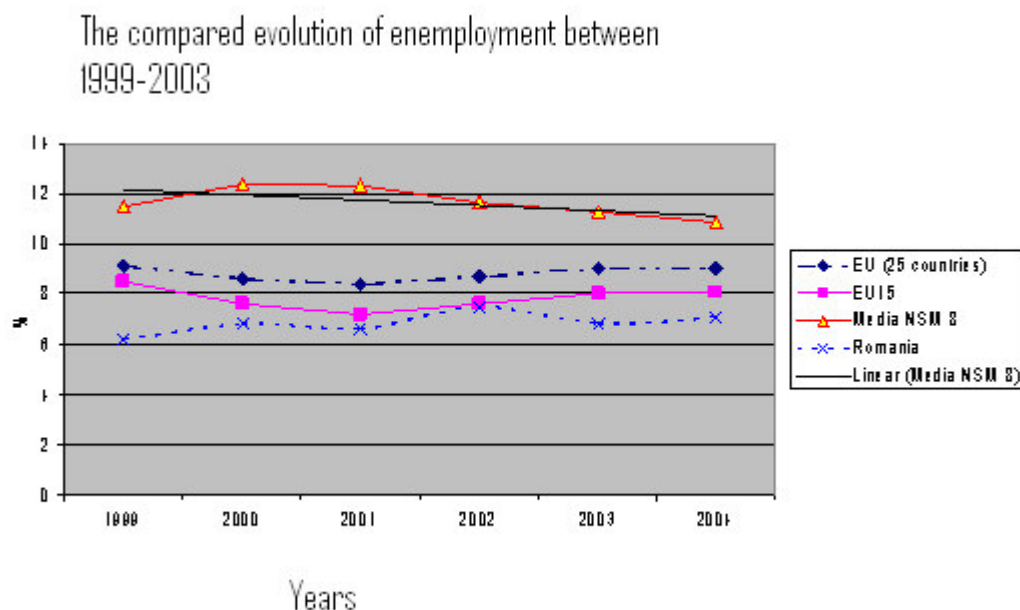


Unemployment

In 2004, the highest rate of unemployment has registered in Poland 18,8%, compared to 19,2% in 2003, in Slovakia (18,0%) and in Lithuania (10,8%).

During the first months of 2005, 21 500 new jobs in Poland, 14 000 in Czech Republic and 3000 jobs in Slovakia have been created: (European Restructuring Monitor, May 2005). It can be appreciated that this increase of jobs in 2005 and 2004 is due to the transfer of some sectors from old EU member states in the new member states, caused by the lower costs registered in the new member states. However, in this states many jobs have been lost because of the restructuring process in sectors like: public administration, transports, communications, and light industry.

FIGURE 1.4



One of the main causes of the high unemployment is its structural characteristic, which determines the low mobility of labor force.

Foreign trade

With the integration of the new 10 member states, EU as a whole has increased its economic power, becoming the world biggest single market (with more than 450 million consumers), and covering around 18% of the world trade.

Moreover, according to the EC evaluation, made one year after adhesion, the exchanges between the old and the new member states have increased in 2004, stimulated by the removal of the last trade barriers and from the benefits inner to the single market (see table 1.5). Additionally, all international treaties and agreements are now negotiated by the European Commission on behalf of the 25 countries.

Besides the benefits of the custom union, the export growth of the New Member States in 2004 was equally due to a general economic recovery of EU-15 member countries and an increased dynamics of the world trade during this period. On the other hand, the dynamics of imports value in the NMS was due not only to the adhesion itself, but to the growth in prices of energy and raw materials on international markets as well (Câmpeanu, V și Albu, C. (2005)).

TABEL 1.5 The evolution of the main external trade indicators in new Member States

Countries	Exports		Imports		Trade balance		Current account balance	
	(real growth against previous year, %)		(real growth against previous year, %)		(% of GDP)		(% of GDP)	
	2003	2004	2003	2004	2003	2004	2003	2004
Poland	17,7	28,0	10,3	6,5	-2,7	-1,1	-2,2	-4,2
Czech Republic	10,1	23,5	8,9	19,4	-2,7	-0,8	-6,3	-5,2
Hungary	9,2	16,7	10,4	13,6	-4,0	-3,0	-8,7	-8,8
Slovakia	28,0	13,3	14,1	15,1	-2,2	-3,5	-0,5	-3,4
Malta	-2,8	3,3	10,5	3,3	-14,5	-15,8	-5,8	-10,5
Cyprus	-4,5	9,9	-4,9	10,6	-23,7	-25,7	-3,0	-5,7
Slovenia	4,4	12,8	7,3	14,5	-2,2	-3,1	-0,4	-0,7
Estonia	5,9	14,1	13,2	15,4	-16,9	-17,5	-12,0	-12,7
Latvia	6,8	7,2	11,3	17,0	-18,1	-20,5	-8,2	-12,6
Lithuania	7,2	10,0	9,9	14,4	-9,1	-10,6	-6,9	-8,0

Source: EC (2005)

Moreover, the evolution of the trade and current account deficits was less unfavourable than what was initially expected. Some countries, as Poland, Czech Republic or Hungary, have even reported lower trade deficits, while in others, e.g. Baltic States as well as Cyprus and Malta, the already high deficits actually increased. The current account balance naturally follows the trends in the evolution of the trade balance, but, in certain cases, reaches alarming levels, putting under uncertainty the sustainability of the external debt.

Basically, it is obvious that the economic and commercial integration continues after accession, following trends emerged in the transitional, pre-accession period, as a direct consequence of the fact that the trade liberalisation in the Central and Eastern Europe countries, current EU members, was achieved during a period that started immediately after 1990.

Therefore, at only one year after accession, major structural breaks in the profile of the external trade are not to be observed as yet. Quite on the contrary, the effects of the adhesion are to be expected in the medium term (see Table 1.6). These changes will be induced mainly through the economic model that the countries are adopting since the beginning of transition. The better the balance between the speed of liberalisation and the one of restructuring was held during transition, the more chances the local companies have to successfully compete on the European/global market⁴.

Moreover, one can expect that the emergent regional specialisation within the EU can hinder a better presence on the world market of the small countries, exporters of raw materials or with a not very diversified economic structure. Two cases are widely referred in the literature:

⁴ Often this process is complicated by the policy of international companies, seeing the central and eastern European countries as very attractive, with highly qualified labour force and low wages, having in the same time important convergence perspectives.

Latvia and Slovakia, both exporters of wood and timber⁵. On the other hand, it is worth mentioning that although the implementation of European regulations on agriculture, that tend to favour intensive agriculture and limit the production of certain traditional agricultural goods, where expect to have a negative impact in countries with a tradition in small scale production, e.g. Poland, this risk is not imminent after the first year of integration.

⁵ Latvia is a country with big endowment in forestry, approx 40% of the land being covered by forests. During the 90ties, FDI entered mostly to activities or primary processing of wood, which lead to an increase in the timber production of around 20-30% per year. The demand for wood and timber in EU member countries (and particularly in Great Britain, Sweden and Finland) being very high, the export of these products of both Latvia and Slovakia rose up to 40% of their total exports (<http://www.foeeurope.org/activities/accession/trade.htm>).

TABLE 1.6 The external trade structure by the main SITC groups, in the three largest New Member States

IMPORTS									
	HUNGARY			POLAND			CZECH REPUBLIC		
	1995	2000	2004	1995	2000	2004	1995	2000	2004
Food products	5,3%	2,7%	5,2%	8,8%	5,6%	5,2%	7,5%	4,6%	4,7%
Non-energetic raw materials	4,4%	2,2%	3,6%	5,9%	3,6%	3,6%	5,3%	3,2%	3,1%
Energetic raw materials	11,7%	8,4%	9,3%	9,3%	10,9%	9,3%	9,6%	9,7%	7,1%
Processing industry products	78,6%	86,7%	81,8%	76,0%	79,9%	81,8%	77,7%	82,5%	85,1%
<i>Total</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>
EXPORTS									
	HUNGARY			POLAND			CZECH REPUBLIC		
	1995	2000	2004	1995	2000	2004	1995	2000	2004
Food products	20,2%	6,9%	8,2%	9,9%	7,8%	8,2%	6,9%	3,7%	3,3%
Non-energetic raw materials	5,4%	2,3%	2,6%	4,5%	2,8%	2,6%	6,1%	3,4%	2,6%
Energetic raw materials	3,2%	1,8%	5,5%	8,2%	5,1%	5,5%	5,3%	3,1%	2,9%
Processing industry products	71,2%	89,0%	83,7%	77,4%	84,2%	83,7%	81,7%	89,8%	91,3%
<i>Total</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>	<i>100%</i>

Source: Authors' calculations based on OECD data

For the 2005-2006, the EC (2005) forecasts the reduction of growth rates of both import and export in the NMS (see table 1.7). The reasons for these slow paces are considered to be: the relative reduction of the world economy and trade growth, the less dynamic domestic demand as forecasted in the EU-15 countries and especially in Germany, Italy, France and the unstable geo-politic climate in many parts of the world. (Câmpeanu and Albu (2005))

The current account balance and the trade balance deficits are forecasted to accentuate only in Poland's case. Hungary and the Baltic States continue to be subjected to the greatest risks related to deficits' financing.

The Czech Republic represents a notable exception, being the only NMS where exports led the economic growth process. The Czech Republic is forecasted to become the only country in the region expected to register, in 2005-2006, the first surplus in the trade balance after 1990 (although in a small proportion), but one which will reach increasing liabilities (passive balances) in the current account balance. In relative terms, situated at 4.7 % of GDP in 2005 and 4.6 % of GDP in 2006, these deficits are not high enough to create problems related to their financing (Câmpeanu and Albu (2005)).

The optimism characterizing these forecasts is justified by the already observed performances. The liberalization and integration continue throughout the Union. The present commercial policy of the EU has set as its main objective the further trade liberalization, according to the neo-liberal principles. The customs tariffs are expected to decrease from 9% to 4%. Still, this policy might affect the sustainability of the economic growth in the EU as a whole, related to the sensitive areas and industries, as well as the impact upon the social conditions and the environment.

TABLE 1.7 Short term forecast: the evolution of the main external trade indicators in the new Member States

Countries	Exports			Imports			Trade balance			Current account balance		
	(real growth against previous year, %)			(real growth against previous year, %)			(% of GDP)			(% of GDP)		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
Poland	4,2	5,0	6,0	1,5	5,5	6,9	-4,3	-4,4	-4,6	-3,2	-3,5	-3,9
Czech Republic	9,5	10,1	9,9	4,5	8,7	9,4	1,7	2,7	3,1	-2,9	-2,6	-2,3
Hungary	10,7	10,6	10,1	8,9	10,9	9,9	-2,6	-2,7	-2,7	-8,4	-8,4	-7,7
Malta	-3,5	0,8	2,6	-2,7	1,9	3,2	-15,8	-16,3	-16,8	-6,7	-6,8	-7,0
Cyprus	15,0	3,8	3,8	2,6	4,8	5,0	-25,9	-26,7	-26,5	-5,8	-5,5	-4,7
Slovakia	7,1	10,3	14,9	8,1	9,6	11,5	-4,9	-4,7	-2,2	-6,6	-6,2	-3,7
Slovenia	9,9	7,8	7,5	6,5	7,0	7,5	-3,4	-3,8	-4,0	-1,6	-1,8	-2,0
Estonia	19,8	16,2	13,3	14,2	11,8	11,5	-16,4	-15,3	-15,0	-9,9	-7,7	-7,1
Latvia	13,1	13,2	12,8	5,5	10,5	10,6	-18,5	-17,4	-16,1	-11,1	-10,5	-9,8
Lithuania	9,8	10,3	9,7	11,1	11,2	10,2	-10,8	-10,7	-10,7	-7,4	-7,1	-7,0

Source: EC (2005)

1.2 The comparative analysis of the indicators

In the next section we will present SWOT analyses (strengths – weaknesses -opportunities – threats) regarding the post-accession evolution of the NMS' economy and the impact of the very moment of this accession upon these economies, as well as upon the newly enlarged EU. There are also presented two national case studies, for the two largest economies in the NMS group, Poland and Hungary.

1.2.1 THE ECONOMIC LEVEL

1.2.1.1. The comparative analysis of some economic performances in the new member states, one year after the EU enlargement eastwards.

The SWOT analysis of the economic performances in the member states

a. The SWOT analysis⁶ of the economic performances in the central and eastern European new member states NMS 8

STRENGTHS – THE FAVOURABLE IMPACT OF ACCESSION	WEAKNESSES – THE UNFAVORABLE IMPACT OF ACCESSION
<ul style="list-style-type: none">▪ The impulse given to economic growth: aggregated GDP in the: NMS⁷ 8: +5% (3.5% in 2003); EU-15:+2.3%.▪ The new member states progressive catch up process with the EU-15 is possible based on the economic growth which has surpassed the Euro-Zone level; the most important growth rates have been achieved in 2004 in Latvia (8,5%), Lithuania (6,75), Estonia (6,2%), followed by Slovakia and Poland (5,5% and 5,3%) [The European Commission Report, march 2005].▪ Factors that generate economic growth:<ul style="list-style-type: none">◦ the dynamic domestic demand, including accelerated pace of the productive investments◦ the introduction of the community funds, which have galvanized the investment activity especially in: the construction area, public works, transports, telecommunications◦ the re-launch of the investment activity in 2004, based on a more favorable tax regime (in many countries), which led to bigger profits for firms and to increased reinvested profits.	<ul style="list-style-type: none">▪ Government crisis due to government deficits and lack of funds: The Polish government went down after two days from the accession, the Czech one two months after the same moment and the Hungarian one after three and a half months. The lack of funds, as well as the government deficits led to critical situations, (the EU discounts the national spending subsequently to this process, from European funds, through a number of bureaucratic and strict mechanisms)<ul style="list-style-type: none">◦ In Hungary, for example, one of the reasons for the governmental crisis, after a short period of time from the accession moment, was the lack of funds which were meant to support the minimum quota needed to take part in auctions for different projects, as well as for the prolongation of the whole activity for the winner projects.▪ The bankruptcy of many companies which didn't manage to adopt modernizing measures prior to accession; these companies deal with the biggest losses in 2005 and cannot catch up. Many of them disappeared.▪ Price explosion: the inflation went up in 2004,

⁶ Analysis based on statistical data from The European Commission Report "Economic Forecasts" Spring 2005

⁷ NMS – new member states

11 World Bank, Economic Report, 1-st.sem. 2005 (there is no reference in the text)

<ul style="list-style-type: none"> ▪ The Agriculture: The biggest beneficiaries of the integration have been the farmers [Laursen , T.B., study World Bank, July, 2005], because once integrated in the EU, the farming goods prices have considerably increased, and the products have benefited from European market entry facilities. The guarantees offered through CAP for cereals, rice, milk and sugar prices (in some cases, the guaranteed prices are higher than the ones existing before the accession), as well as the trade barriers' removal have been positive factors that helped the farmers in the east. <ul style="list-style-type: none"> ◦ The conditions have been favorable for farmers in Poland, Slovakia, Slovenia, Hungary, Czech Republic, Latvia, Lithuania, Estonia, but in Poland and The Czech Republic the farmers benefited the most and the most important progress was achieved by the medium sized farms, which have produced for the their own market and consumption. ▪ The relaxation of the fiscal policies in some countries (Poland, Estonia, Lithuania) led to better fiscal results in 2004. Except Hungary, better fiscal results than forecasted have been achieved through intensified production and high revenues and, only in a few cases, through the reduction of the spending. [Economic Report I-st. sem., World Bank]. <ul style="list-style-type: none"> ◦ In all of the 8 countries there was an inverse relation between the income taxes and the number of employees, every percent that marked a decrease in the revenue taxes has been reflected in the increasing with more than 1% of the employee number. [World Bank] ▪ The reduction of the government deficit in 2004 (% of GDP) has been achieved through a number of budget austerity programs, along with new methodologies for collecting taxes, included in the European Commission development plan on a medium term. (2004-2008) ▪ The trade flows between the new and the old member states have increased in 2004 as a result of the advantages provided by a custom union and one internal market. NMS-8 exports have recorded accelerated paces in 2004 and increased with 1-3 percentage points related to EU-15 as an outlet for their exports. 	<p>especially in Poland, Hungary, Czech Republic, Latvia, Estonia as a result of a price alignment process for certain products and services in the EU-15 and of some taxes and duties, but also as a result of other factors as the increasing intentional oil, gases, and metal prices.</p> <ul style="list-style-type: none"> ▪ The loss of many jobs as a result of the restructuring process: the unemployment rate maintained at high levels in 2004 (except Hungary and Slovenia). There have been done restructures in the following areas: public administration, transports, communications, food industry and light industry. The production dynamics wasn't associated with the reduction of the unemployment rate, especially in Poland and Slovakia. ▪ The stagnation of some member states exports on the EU Internal Market: The increasing pace of the exports towards EU-15 countries slowed down in Poland, Slovakia, while in 2003 they reached the highest growth rates comparative to the other six central and eastern European NMS. ▪ The increasing current account deficit: the increasing current account balance deficit in 2004 (except Poland and The Czech Republic), with unfavorable consequences upon the international currency position of the new member states. The current account deficit remained very high in the Baltic countries and Hungary.
OPPORTUNITIES IN 2005-2006	THREATS IN 2005-2006
<ul style="list-style-type: none"> ▪ The new member states in the EU, especially the Baltic countries, have a great economic growth potential, estimated at a 5% level in 2005 and 5,1% in 2006, above the forecasted levels for the Euro-Zone, of 1,6% and 2,1% [Economic Forecasts Spring, The European Commission, April, 2005] 	<ul style="list-style-type: none"> ▪ The first half of 2005 has been characterized by a drastic decrease of the economic activity. (Poland, Hungary and Slovenia recorded the lowest growth rate of the GDP). <ul style="list-style-type: none"> ◦ One year after the accession, the new member states economies show signs of weakness. "The future is not so bright for the new members [Laursen, T.B.,

<ul style="list-style-type: none"> ▪ The inflation shock of the accession will be absorbed in 2005-2006, the inflation rate being expected to drop (except Estonia and Lithuania), under the influence of the preparing measures for the euro endorsement. The inflation level will stand under 3%/year in the majority of the NMS (except Hungary and Latvia where inflation is estimated at 3,6%). ▪ The creation new jobs in 2005 and 2006 will be achieved through the relocation process within the EU-15 industry, directly related to the lower costs in the new member states. ▪ The trade balance deficit will attenuate in 2005-2006 in those states that have reached very high levels in 2004 (The Baltic states 10-20% din PIB) ▪ Free capital movement between the EU-25 member states will increase the interest for capital placement in the new member states. <ul style="list-style-type: none"> ◦ the safety of the operations and of the banking system will increase ◦ the financial services costs will decrease and that will facilitate the economic development of the new member states and a gap reduction between them and the EU-15 ▪ The purchasing power will increase and also the demand for new products ▪ There will be an increase in the credit and loan values for the new member states granted by the international financial entities, under better conditions 	<p>study World Bank, July, 2005]. The economic recovery and the gaps' diminishment compared to the rich countries no longer depend on the European budget, given the fact that there has been imposed a limitation, on the possibilities of the new member states, to absorb these funds.</p> <ul style="list-style-type: none"> ▪ The economic growth pace slows down or stagnates in 2005. The start in 2005 was rather slow for most of the new member states, reforms have been modest, and as in most countries elections have been organized. ▪ The production dynamics in the NMS might be slower in 2005 under the influence of: <ul style="list-style-type: none"> ◦ the reductions of the foreign investments in all member states (except The Czech Republic) ◦ the reduction of the productive investments pace ◦ the real appreciation of the euro and public uncertainty in some member states (the depreciation of the euro signaled in the autumn of 2005 might be the premises for a recovery of the European economy, if the trend will persist) ▪ The resort to the labor force will not bring any changes, the highest unemployment rates will continue to be registered in Poland and Slovakia ▪ The decrease in the export growth rate in 2005-2006 in most of the new member states, influenced by the slow economic and commercial growth ▪ The trade deficit keeps on growing in 2005-2006 in four of the eight central and eastern European countries and the on-going decrease of the Estonian exceeding budget ▪ Problems with the current account balance deficit's financing will be recorded especially in Hungary and the Baltic States, where the current account deficit will reach high levels, of about 9-12% of GDP in 2005.
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b. The SWOT analysis of the economic performances in the EU-25

STRENGTHS – THE FAVORABLE IMPACT OF THE ACCESSION UPON THE EU - 25	WEAKNESSES - THE UNFAVORABLE IMPACT OF THE ACCESSION UPON THE EU - 25
<ul style="list-style-type: none"> ▪ The increase of the population with 74,1 million individuals (19,4%) at a level of 456,8 million individuals ▪ The increase in production activity and services, productivity and technological progress ▪ Infrastructure development ▪ The increase of EU-15 direct investments in 	<ul style="list-style-type: none"> ▪ The enlargement has caused a insignificant economic growth in EU-25, of 2,4% in 2004 (2,3% in EU-15). The economic growth is a lot smaller then the population increase (19,4%). ▪ The entry of new and more rigid regulations concerning the community consumer safety generated three times more products being withdrawn off the European market; the most affected countries were Germany, Hungary and Spain.

<p>the new member states.</p> <ul style="list-style-type: none"> ▪ The intensive EU internal trade ▪ Small labor force migration from the new member states, despite the expectations. 	<ul style="list-style-type: none"> ▪ Real estate acquisitions in the central and eastern European countries, considered by the western Europeans as being very attractive before the enlargement, have become unattractive, especially after the national currencies in the new member states started to value up in relation to the Euro (significant valuation has been registered in 2004 Hungary, The Czech Republic, Poland, Slovakia, with 20-30%). ▪ The most expensive capitals: Budapest ranks 24 in the most expensive capitals of the world top and is the first between the 10 new member states. Another expensive capitals are: Warsaw, Prague, Bratislava (ranking the 27, 28 and 33 from a total of 144 capitals from all continents).
OPPORTUNITIES IN 2005-2006	THREATS 2005-2006
<ul style="list-style-type: none"> ▪ EU's increasing role at an international level: the EU-25 countries have easily surpassed in 2004 the US contribution to the world GNP (30,4% comparatively with 30,0%) ▪ The EU enlargement can increase the EU-15 GNP with 0,5-0,7% annually, between 2005-2009. ▪ On a medium term, the economic growth and the creation of new jobs in EU-25 could be achieved through a EU competitiveness increase on a global scale. Related to this aspect, the global plan to enforce The Lisbon Strategy, presented by the European Commission in 2005, with 94 concrete actions in eight priority areas, could reverse the existing world trends. <p>The Action Plan's priority areas elaborated by the European Commission (2005) are:</p> <ul style="list-style-type: none"> ◦ Supporting innovation and knowledge ◦ The state aid policy reform and the simplifying process of the European legislation concerning undertaking activities ◦ The completion of the Internal Market of Services ◦ Concluding an <<ambitious agreement for the EU>> in the Doha Round, concerning multilateral trade negotiations ◦ Eliminating the obstacles concerning the free movement of labor force ◦ Developing a common approach regarding the economic migration ◦ Supporting the employees affected by restructures <p>This action plan will be completed by the 25 national reforming plans which are being prepared by all member states and which have to be finished by the end of October 2005.</p> <ul style="list-style-type: none"> ▪ The new member states economy will 	<ul style="list-style-type: none"> ▪ Europe is losing ground to USA and other dynamic regions like Latin America, India and China, regarding the GDP or the productivity, and the occupied labour force level is low [G. Verheugen] ▪ The possible specialization of the intra-community trade: the old member states will export high technology products and will import raw materials and intensive products in labor force, including food products. There will be competition between the NMS on this last segment. ▪ The potential migration on a long term from the 10 new member states is a false threat, being estimated at the most 4% of their population (meaning 3 million people) or 0,8% of the EU-15 population. Moreover, this threat can be switched into an opportunity for the EU, confronted with a labor force ageing process at a high degree.

<p>generate 300.000 new jobs</p> <ul style="list-style-type: none"> ▪ The enlargement will intensify the trade between the new and the old member states. ▪ The economic growth acceleration in the new member states causes an increasing need of investment goods and an increase of imports from EU-15. ▪ The raw materials and semi-manufactured products imports from the new member states will contribute to an increase in the producers' and importers' competitiveness in The EU-15. ▪ The EU-15 business, financial commercial and services exports will also increase, being imported cheaper services due to the low costs in the NMS labor market. ▪ The labor force migration from the NMS will decrease, once the income per capita differences is balanced. During the first years after the accession, migration is estimated to 200.000 – 300.000 individuals per year, which will not cause problems on the EU markets. 	
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Source : Virginia Câmpeanu, The Economic Evolution In The New Member States And Perspectives For 2005-2006, IEM, JULY 2005

Case studies: SWOT analysis of Poland's and Hungary's economic performances

a) Poland: SWOT analysis for the first year after the accession

The Polish economic evolution after the EU accession had a constant positive trend. “The internal market's growth and development, the stable currency situation, good performances in the external trade and the prices' slow increase are essential elements which outline the Polish economy after almost a year from the EU enlargement” [T. Suprowicz, The Polish Embassy in Bucharest, 24.03.2005]

STRENGTHS – THE FAVORABLE IMPACT OF THE ACCESSION	STRENGTHS – THE UNFAVORABLE IMPACT OF THE ACCESSION
<ul style="list-style-type: none"> ▪ “The EU member status represents a substantial transformation, on a long term, not a miracle or a disaster that happened overnight” [T.Kolodziej, IER seminar, may 2005] ▪ Poland's accession moment has been prepared long before 1 may 2004, and so, the business environment didn't perceive it as a critical moment. The commercial 	<ul style="list-style-type: none"> ▪ Price explosion in 2004 (the inflation rate increased from 0,7% in 2003 to 3,6% in 2004), as a result of an alignment process to some goods and services prices from EU-15 and some increased taxes and duties, but also because of other factors as the oil, gas, ferrous or non-ferrous metals international prices going up.

<p>integration has been achieved throughout the last 10 years, and at the moment of the accession, the benefits had already been present within the business environment.</p> <p>Impelling the economic growth. The economy has been fully assimilated with the EU market [T. Suprowicz, The Polish Embassy in Bucharest, 24.03.2005]. The main developed branches:</p> <ul style="list-style-type: none"> - the food industry - the furniture industry - agriculture - banking & financial services - watering tourism <ul style="list-style-type: none"> ▪ The reestablishment of the undertakings' situation: the net financial coefficient has registered an increase of 3,5 times. ▪ Economic growth generating factors: <ul style="list-style-type: none"> ◦ the dynamic domestic demand, including the accelerated productive investments' pace ◦ Poland's attractiveness for foreign investors: the largest foreign investments in the region (70 billion dollars in the last few years); only in 2004, direct foreign investments have increased with 23% comparatively with the year before (reaching 7,86 billion dollars), being mainly generated by the extension of the already existing foreign businesses in Poland and not by their increased number. ◦ the loosening of the fiscal policies in Poland led to better fiscal results in 2004 ◦ the external trade has been the main factor for economic growth. In 2004 the export's value reached 48 billion euros, 22% more than 2003. 	<ul style="list-style-type: none"> ▪ On the construction material market the prices went down, the black market developed and the prices increased with 5-15% after a year from Poland's accession to the EU. The recession on the construction material market was caused by a VAT increase from 7% to 22%. The merchandise on the black market (VAT and revenue tax free) is being sold 30% cheaper than the legal competitors. The clients have abandoned the construction and renovation plans, guiding their financial means towards second-hand cars or investing in the stock exchange markets. [Wyborcza Gazzette, quoted by Rompress]. ▪ Agriculture: the rules concerning the subsidies for agriculture displeases the Polish farmers, which are accusing big delays regarding the payments from the EU and the lack of sponsors for the agricultural deposits in the country. (the EU announced that it will pay 100/tonne in November 2005, but the farmers needed the money in August in order to cover al the spending related to harvesting and sowing the autumn crop). The farmers consider that the minimum level for granting the subsidies should be reduced from 80 tones to 20 tones. ▪ The unemployment rate maintained high in 2004. Many jobs have been lost as a result of the restructure process. ▪ The export's growth pace towards the UE-15 member countries slowed down in Poland, following the biggest growth paces in 2003 comparatively to the other 6 central and eastern European new member states. ▪ The farmers' advantages generated by the European funds and by the increasing agricultural exports have been attenuated by the diesel oil and fertilizers high prices.
<p>In the first few months after the accession (May – December 2004), exports towards other member states have increased by 35%, compared to the same period the previous year.</p> <ul style="list-style-type: none"> • Agriculture: The increase of the agricultural exports (by over 25% after May 1st 2004) and the influx of European funds have lead to a 30% increase in farmers' incomes, starting with the date of accession. • The most advantaged Poles after the accession are farmers, young people, researchers and consumers [T. 	

<p>Kolodziej, seminar EIR, May 2005].</p> <ul style="list-style-type: none"> • The impact of competition regulations on Poland's accession was rather smooth, as there was no "big bang" on May 1st 2004. Several factors have contributed to Poland's success in this area: <ul style="list-style-type: none"> -First of all, a good alignment with the community acquis on competition, established during the negotiations; -The participation of the new member states in the European competition Network; -The existing state aid mechanism; -The coordination with the national bodies on state aid, after accession [N. Kroes, Speech 05/382, 24 June, Warsaw); 	
OPPORTUNITIES IN 2005-2006	THREATS IN 2005-2006
<ul style="list-style-type: none"> • Free movement of capital between the EU-25 member states will increase the interest for capital placement in the new member states. <ul style="list-style-type: none"> ○ The safety of the operations and of the entire banking system will increase ○ The costs associated to the financial services will decrease, which will facilitate economic development in the new member states and the decrease of the gaps against the EU-15. ○ Productive investments will continue to increase at an accelerated pace; entrepreneurs have already begun to invest with more courage. Under these circumstances, the fear of unemployment of the Polish population will decrease. [The rate of growth of productive investments has accelerated starting with 2004, with an estimate of 10% increase for 2005 (5,6% in 2004) and 11% for 2006]. 	<ul style="list-style-type: none"> • In 2005, Poland's economy has developed rather slowly. Reforms have had a slow advance; the Hausner Plan has been only partially implemented. • The use of labor force will not improve; Poland will continue to have the highest unemployment rates in 2005. The state of mind of Polish consumers has worsened at the end of the first quarter of 2005, the main reason being fear of unemployment. The most scared are the employees in the private sector, followed by those in the budgetary sector, pupils and students [Ipsos, opinion poll, March 2005]. • The exports growth rate will slow down in 2005-2006, influenced by the overall slowdown of economic growth and global trade. • Agriculture: the advantage of Poland's agricultural surface is diminished by the fact that the level of subsidies is less than half of those received by Western farmers. • In the area of state aid, Poland still has to deal with some problems, like: solving the remaining cases, on the basis

<ul style="list-style-type: none"> • Large construction materials producers protect themselves against recession by selling lower-quality, yet cheaper products; other companies turn towards export, especially on the Russian market; wholesale centers propose services for their own construction teams, because of the special tax applied for this kind of sales, of only 7%. • Agriculture: Poland has an agricultural surface twice as big as that of France or Spain. Poland receives from the European Union over 3,1 billion euro a year as subsidies for agriculture, 0,7 billion euro for price compensation on agricultural products and 1,2 billion euro for rural development. 	<p>of the transitory mechanism (for which transitory periods have been granted during the negotiations).</p> <ul style="list-style-type: none"> ○ At the same time, technical discussions are under way, for interpreting some concepts like the principle of restructuring aid – “one time, the last time”.
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Source: Virginia Câmpeanu - The Evolution of the Economic Climate in the New EU Member States and Perspectives for 2005-2006, IWE, July 2005.

b). Hungary: SWOT analysis in the first year after the accession

STRONG POINTS – FAVOURABLE IMPACT OF THE ACCESSION	WEAK POINTS – UNFAVOURABLE IMPACT OF THE ACCESSION
<ul style="list-style-type: none"> • Hungary has the advantage of having overcome the accession moment without great changes, as it had begun the accession preparations since 1994 (at the same time with the implementation of the European Agreement) and since then it has continued to do so, regardless of the sometimes shifting EU position. [J. Halasz, Hungary’s Embassy in Bucharest, July 2005] <ul style="list-style-type: none"> ○ The beginning of the administrative reform in 1993 and the transparent way of obtaining money from public and private funds, through biddings, have constituted advantages, as a whole generation has learned how to access funds. • In 2005, there are 12% more firms registered, compared to those before the accession, and many of them have 	<ul style="list-style-type: none"> • In Hungary, one of the reasons for the fall of the Government three months after the accession was the lack of funds necessary to ensure the minimum level necessary for the participation in biddings for projects, as well as for the pre-finance of the activity of the winning projects (which is afterwards deducted from the European funds). • Some firms went into bankruptcy after the accession: 50% of SMEs went bankrupt (but new ones emerged). Especially the big companies, that couldn’t handle the competition, suffered great losses. • Farmers did not receive the subsidies from Brussels on time, which gave way to protest. • There was a fiscal shock: many VAT

<p>the accession, and many of them have foreign capital.</p> <ul style="list-style-type: none"> • The myth of mass bankruptcy of SMEs after the accession was diminished by substantial preparations: over 40.000 micro-enterprises from more than 2000 towns have participated at professional trainings, which offered general, as well as detailed information for each qualification. • Hungary has not become a net contributor to the EU, although some calculations revealed that five times more money could have been accessed from the EU. • Hungary's exports grew at an accelerated pace in 2004 (17% compared to 8% the year before accession), which has allowed a decrease of the trade balance deficit (2,8% of GDP). 	<p>taxes increased, which lead to a price increase, especially for the goods/services directly affected by the change.</p> <ul style="list-style-type: none"> • After the accession, purchasing power decreased, even though there has been no public acknowledgement that the real value of incomes and pensions has decreased. • Unemployment had a tendency to rise in 2004, as a result of the fact that investors started to relocate production eastwards. • Tactical imports were made immediately after the accession, due to the insecurity regarding various post-accession phenomena, which had negative short-term effects on the trade balance.
OPPORTUNITIES IN 2005-2006	THREATS IN 2005-2006
<ul style="list-style-type: none"> • Inflation was blocked in the first half of 2005, after the high level of the previous year, and is estimated to have a downward trend until 2006. • There has been an increase of GDP, external trade, industrial production and real average income (by 9%). • Unemployment rate had a slightly upward trend after the accession, but is it among the smallest of the new member states (the second smallest after Slovenia). • For Hungary, the main challenges refer to maintaining economic growth, keeping the labor force inside the country, developing human resources, getting stronger access to European funds, attracting knowledge-based capital and promoting the export of capital by developing companies at a regional level. [Halasz, 2005] 	<ul style="list-style-type: none"> • Foreign invertors are relocating production eastwards, were labor force is cheaper, which may constitute an important factor for further increasing unemployment. • Hungary, as the old member states, is confronted with demographic decline.

Source: Virginia Câmpeanu - The Evolution of the Economic Climate in the New EU Member States and Perspectives for 2005-2006, IWE, July 2005

1.2.1.1 SMEs in the candidate countries from Central and Eastern Europe before EU's enlargement eastwards

During the past decade, Central and Eastern European countries have undergone a process of profound structural changes. After the definitive break from the Communist regime in the beginning of the 1990s, the development of SMEs has become the focal point of economic reform policies for all the governments in the region.

Many new SMEs were created and entrepreneurship was promoted, by the privatization or restructuring of the old state-owned enterprises. To a certain extent, this was an important shift from the economic activity in inefficient state-owned companies to private companies. At the level of the national economies, the positive effects brought by the production and the creation of new jobs of the new SMEs have partially compensated the loss of jobs and the decrease in production in big enterprises, at least in the first half of the 1990s.

Definition and characteristics of small and medium enterprises in the EU

Small and medium enterprises (SMEs) are defined in the EU as enterprises with less than 250 employees.

There are at least 4 size classes of SMEs⁸, according to the number of employees:

- a) non-salaried employees (0 employees)
- b) 1-9 employees
- c) 10-49 employees
- d) 50-249 employees

For the EU, the sectors Construction and Transport, Storage and Communication are dominated by enterprises without salaries employees. In the Wholesale and Retail trade sector enterprises with 1-9 persons dominate.

Table 1.8 Structure of enterprises in the EU, by size classes and economic sectors

Economic sector	Total number of enterprises thousands	SMEs with 0 employees %	SMEs with 1-9 employees %	SMEs with 10-49 employees %	SMEs with 50-249 employees %	Large enterprises +250 employees %
Manufacturing	2048	34	47,2	14,9	3,1	0,8
Constructions	2504	51,9	40,7	6,7	0,6	0,1
Trade (wholesale, retail)	2948	44,5	50,2	4,7	0,5	0,1
Transport, storage, communications	997	59,2	33,9	5,8	0,9	0,2

Source: based on data from "Basic statistics on SMEs & credit institutions", Briefing STAT 506 EN, Luxembourg, July 2003

The role of SMEs in the Central and Eastern European candidate countries

⁸ Basic statistics on SMEs & credit institutions", Briefing STAT 506 EN, Luxembourg, July 2003

The creation of small and medium enterprises has taken off afterwards, so that at the beginning of the 2000s the Central and Eastern European candidate countries had almost 6 million SMEs, which employed over 20 million persons.

Structure of SMEs: 95% of the total number of SMEs are micro-enterprises (with an average of 2 employed persons/enterprise); almost 4% are small enterprises (22 employed persons on average) and less than 1% are medium enterprises (107 employed persons on average).

Of the 20,5 million employees in the SMEs from the central and Eastern European countries, half work in micro-enterprises, 24% in small enterprises and 26% in medium enterprises.

In the same year, in the 10 Central and Eastern European countries there were 10 thousand large enterprises, with over 10 million employees, representing 33% of the total number of employed persons.

The analysis of the specific statistical indicators shows the dominance of small and medium - class enterprises in the pre-accession period in the candidate countries.

Comparisons between the EU and the candidate countries regarding the role of SMEs

a) *The distribution of enterprises on size-classes is similar in the candidate countries to that in the EU-15, with a prevalence of SMEs: SMEs dominate the number of enterprises with 99,8% in the EU and 99,7% in the candidate countries.*

For example, in 2003, in the European Union and in other four Western European countries⁹ there were more than 19 million SMEs, that provided jobs for approximately 140 million persons (70% of the total) and only 40.000 large enterprises (0,02% of the total number of enterprises) that provided approximately 42 million jobs (30%). In the candidate countries, SMEs represented 99,7%, covering 67% of the total number of employed persons.

b) *The total number of SMEs in Western Europe is 3 times bigger than in the candidate countries, and the total number of employees in SMEs is approximately 5 times bigger.*

Table 1.9 The role of SMEs in the candidate countries and the EU

Table 1.9 The role of SMEs in the candidate countries and the EC							
		SMEs				Large enterprises	Total
	UM	Micro	Small	Medium	Total		
<i>Candidate countries (2001)</i>							
Enterprises	1.000	5.670	230	50	5.950	10	5.970
Number of employees	1.000	10.210	4.970	5.350	20.530	10.150	30.670
Number of employees/enterprise		2	22	107	3	919	5
Predominance according to size						Small/medium	
<i>Europe-19 (2003)*</i>							
Enterprises	1.000	17.820	1.260	180	19.270	40	19.310
Number of employees	1.000	55.040	24.280	18.100	97.420	42.300	139.710

⁹ EU-15, Iceland, Norway, Switzerland, Liechtenstein

Number of employees/enterprise		3	19	98	5	1052	7
Predominance according to size							Micro

*EU-15, Iceland, Norway, Switzerland, Liechtenstein

Source: European Economy, Supplement A, May 2003; OECD: Economic Outlook, No.71, June 2003

c) Most enterprises from the European Union are micro-enterprises, with 0-9 employees, while the majority of SMEs in the candidate countries are medium-sized.

The analysis of the statistics regarding the detailed structure of small and medium enterprises in the European Union (EU-15) shows the fact that the number of micro-enterprises is relatively stable (in 2003, there were 0,04% less micro-enterprises than in 1997), considering the fact that while some exited the market, others entered [based on data available in “Basic statistics on SMEs & credit institutions”, Briefing STAT 506 EN, Luxembourg, July 2003].

Table 1.10. Main indicators for SMEs in EU countries, in 2003

Number of enterprises		Number of employed persons per enterprise	Dominance on enterprise size*	Added value per employee**	Propensity to export for SMEs***	Percent of added value in total
thousands				Index, total/country=100	%	%
Austria	270	11	Micro	78	-3	-3
Belgium	440	7	Micro	93	-6	-2
Denmark	210	10	Small, medium	93	-3	-1
Finland	220	7	Large	85	-6	1
France	2500	8	Micro	76	-7	-4
Germany	3020	10	Large	90	-6	5
Greece	770	2	Micro	98	-1	2
Ireland	100	10	Small, medium	50	6	2
Italy	4490	4	Micro	89	-4	-0
Luxembourg	20	9	Small, medium	101	-1	-1
Netherlands	570	12	Large	95	-4	-1
Portugal	690	5	Small, medium	74	-2	-6
Spain	2680	6	Micro	82	-4	-0
Sweden	490	7	Micro	87	-3	-0
Great Britain	2230	11	Large	69	-4	-5
EU-15	18700	7	Micro	74	-5	-3

* A country or an industrial sector is considered to be mainly micro, small and medium, or large, when either micro-enterprises, or small and medium ones (taken together) or large ones hold the largest share of the total employed population;

** Index, total per country =100

*** Share of exports in total turnover (%) – SMEs minus total per country

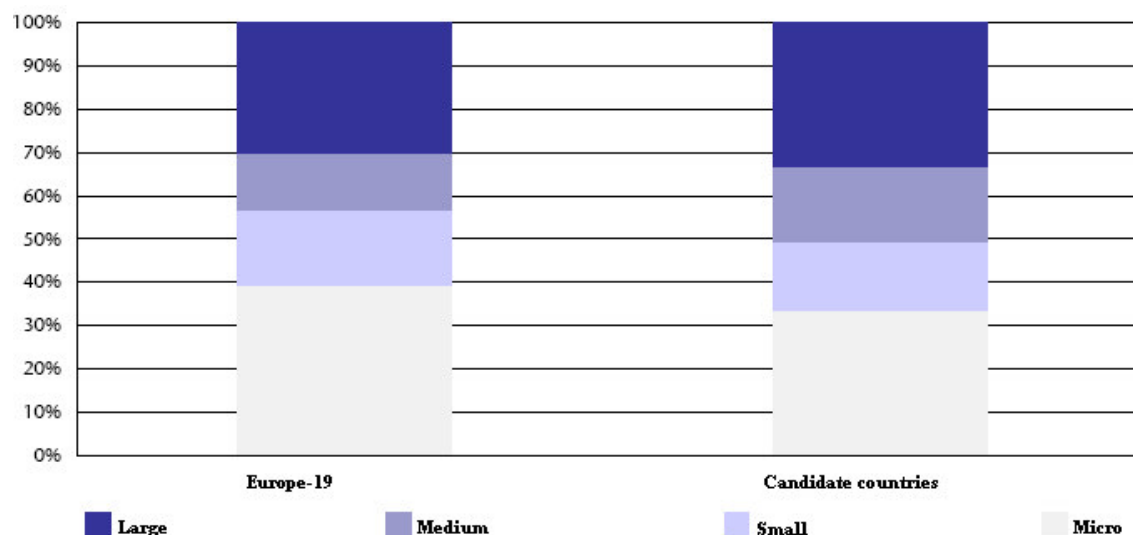
**** Added value as percent of turnover – SMEs as deviation of country total

Source: European Economy, Supplement A, May 2003; OECD: Economic Outlook, No.71, June 2003

d) Micro-enterprises with 0 employees in EU-15 dominate both micro-enterprise structure (9,2 million or 53% of the total number of micro-enterprises have 0 employees, the rest of 8,2 million have 1-9 employees), and the structure on the SMEs total (49%).

This characteristic of the dominance of micro-enterprises with 0 employees in EU-15 does not have an equivalent in Romania, where micro-enterprises are obliged to have at least one employee; even more, in the first half of 2005 there have been some government proposals stating that the minimum number of TCEE micro-enterprises should be at least 5, and even greater in large enterprises, compared to EU-19.

FIGURE 1.5. Distribution of employed labor force by size classes of enterprises in Europe-19 and the candidate countries



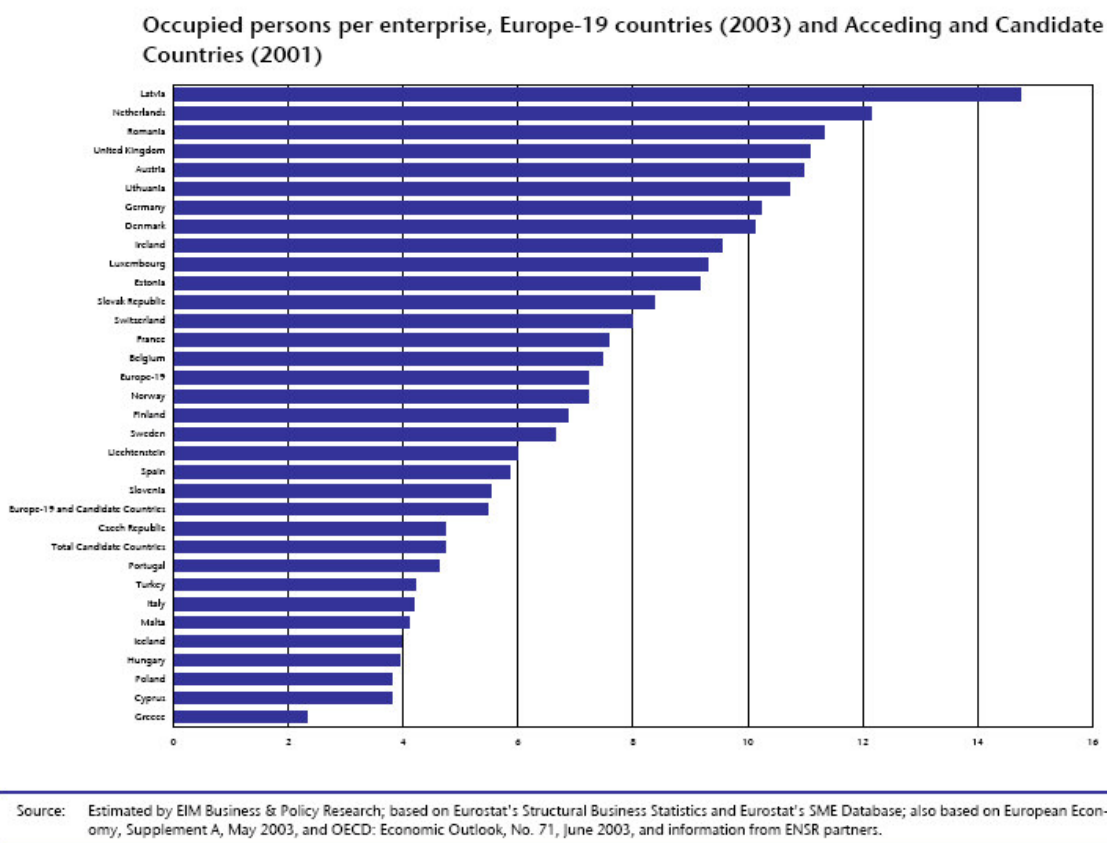
Source: European Economy, Supplement A, May 2003; OECD: Economic Outlook, No.71, June 2003

f) Starting with the second part of the past decade, *there has been a decline in size of the micro-enterprises in the candidate countries*, which suggests a convergence process towards the medium size of enterprises in Europe.

There are significant differences between countries in what the medium size of the enterprises is concerned, from the point of view of the number of employees. In some candidate countries, especially in the Baltic States and Romania, the medium size of SMEs is significantly bigger compared to those in Western European countries.

Latvia has a medium number of 15 employees per enterprise, in the top of the analyzed countries, and Lithuania 10,8 employees (6th place). Among EU-15 countries, the largest enterprises if taking into consideration the medium numbers of employees are: The Netherlands, Great Britain, Poland (under 4 employees), Cyprus and Greece (under 4 and 2%, respectively). Romania has a medium number of 11.4 employees/ SME (on the 3rd place in a hypothetical top).

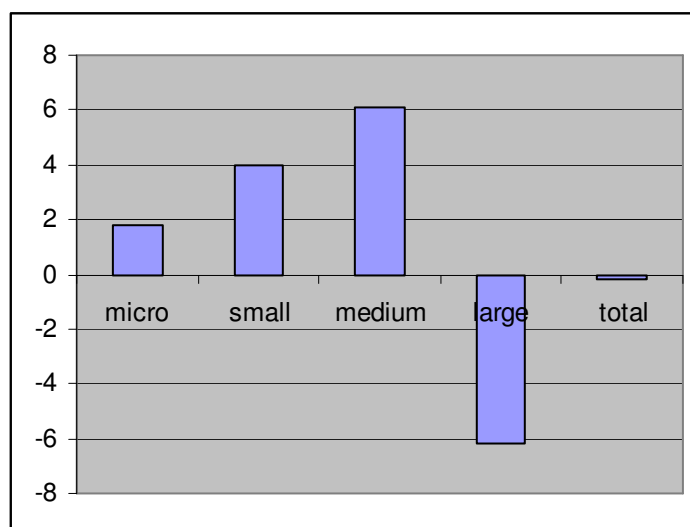
FIGURE 1.6 Occupied persons per enterprise, in EU-19 and candidate countries



g) There are some changes in the evolution of the number of employees in the candidate countries on types of enterprises, which is different from the Western European countries, especially *the decrease of the role of micro-enterprises and the significant reduction of the large enterprises, at the same time with the increase of the importance of small and medium enterprises in employing the labor force.*

The evolution of the number of employees on types of enterprises reflects the special nature of the economic development in the central and Eastern European candidate countries, where the ex-state owned enterprises have closed, small and medium enterprises took their place and the number of employees in SMEs increased.

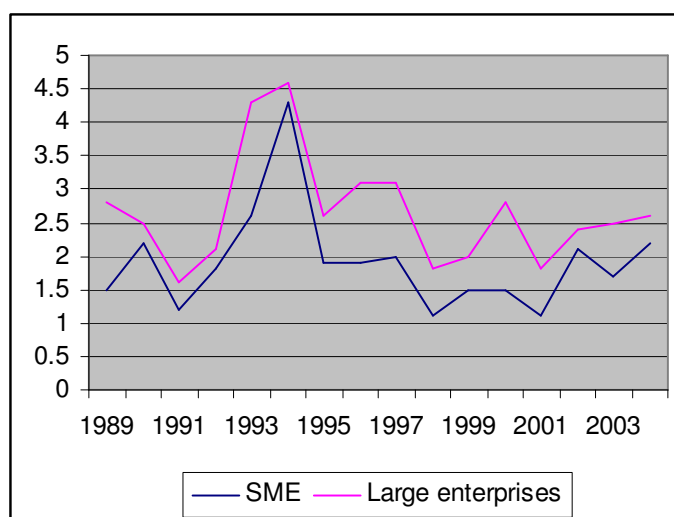
FIGURE 1.7 The increase of the number of employees depending on enterprise size, in the candidate countries (1995-2001, medium changes in % per year)



Source: European Economy, Supplement A, May 2003; OECD: Economic Outlook, No.71, June 2003

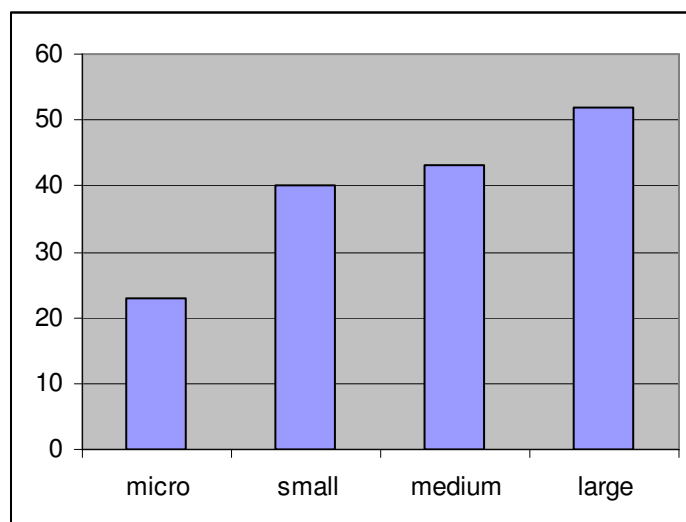
In Western European countries, the number of employees increased mostly in micro and small enterprises and decreased in large enterprises, due to the fact that labor productivity grows faster in large enterprises and these become more efficient than SMEs (especially than micro-enterprises). The explanation lays in the fact that SMEs from Western Europe perform mainly in economic sectors with low productivity, like retail [The Observatory of European SMEs, nr.8/2004].

FIGURE 1.8 The evolution of labor productivity of SMEs and large enterprises, in EU-19, 1989-2004



h) *The experience of Western European countries shows the greater profitability of large enterprises. Profitability decreases with size.*

FIGURE 1.9 Profitability*, function of enterprise size, in EU-19, in 2003



*Gross operational surplus, adjusted to net incomes of free-lancers, as % of gross added value.

Source: European Economy, Supplement A, May 2003; OECD: Economic Outlook, No.71, June 2003

i) Although there are no comparative data regarding the constraints that affect SMEs performance, on different size classes, we present the results of an opinion poll taken in Western European countries [ENSR Enterprise Survey, 2003]:

- a. The main constraint for one third of SMEs was low purchasing power of customers, as a result of bad economic climate; the smaller the enterprise is, the stronger this constraint (37% for micro-enterprises).
- b. Lack of highly skilled labor force and access to finance are next on line, as well as administrative regulations, which do not have a direct connection to the economic climate, but are very important to stakeholders. The lack of highly skilled labor force is more important for medium sized enterprises, which can constitute an element of interest for the mobility of the new member states.
- c. Other factors of constraint, with a lower impact on business are: infrastructure, implementation of new technologies, implementation of new forms of organization, quality management.

1.2.2 SOCIAL ISSUES

1.2.2.1 General overview on the reform of the social security systems and their transformational framework

As a component of the integration strategies and following the concrete initial development conditions, the social policies have vary substantially from a country to the other during the transition period. This followed the specific tensions and needs for social assistance and raised questions on the extent in which the countries in Central and Eastern Europe move towards the European social security model and, in each case, which would be the most appropriate trajectory giving the variety of integration models.

Several attempts of grouping the region's social systems according to various criteria that seemed relevant at different stages of the transition period were proposed in the literature.

The World Bank and UNDP taxonomies relate to the policy choices of the governments with regards to the introduction of the market institutions at the middle of the '90ties. The real meaning of these taxonomies is not fully clarified in the literature, and these exercises are limited in scope and relevance. There are as well very few successful attempts to compare countries according the effects of the social policies.

Typologies of social policies and reforms in the Central and East European Countries (1995-2000)¹⁰

- **World Bank**¹¹

Most reform: Poland, Slovenia, Hungary, Croatia, Macedonia, Czech and Slovak Republics

Some reform: Estonia, Lithuania, Bulgaria, Latvia, Albania, Romania

Less reform: Russia and CIS

- **Națiunile Unite**¹²

Liberal approach: Poland, Czech Republic, Hungary, Baltics

Late reformers: Bulgaria, Romania

Non-liberal: Belarus

Conflict over whether to liberalize: Russia, Ukraine, Slovakia

- **Deacon (2000)**¹³

West European welfare state: (*mixed Bismarck Insurance, e.g. payroll taxes, and Scandinavian state*

finance) Czech Republic, Hungary, Poland, Estonia, Slovenia

Conserve state and workplace benefits: (*which may collapse and lead to residualisation*)
Russia, Bulgaria, Romania, Macedonia

Although all seem as advanced, the social security systems in NMS are different from each other: while Czech Republic choose a system of universal coverage, Poland show a more pronounced tendency towards a more liberal system, with individual coverage, with Hungary being somewhere in between. Moreover, the literature failed to identify a clear tendency for convergence of social security systems of NMS, due to the specific national conditions and to the sensitivity of the national socio-economic systems to the influence of the external factors (Rys (2001)). Regarding the external factors, it is well known that the social and political situation in these countries is influenced by the strategies of the international organisations, promoters of the globalisation, on one hand (IMF, WB), and on the other hand by the EU integration itself (see Deacon (2000), Ferge (2001a), Wagener (2002)). Nevertheless, even if the effect of the strategies of international organisations cannot be ignored, it impacts only

¹⁰ Following Manning, N (2004) "Diversity and change in pre-accession Central and Eastern Europe since 1989", *Journal of European Social Policy* 14 (3)

¹¹ World Bank (1996) *From Plan to Market: World Development Report 1996*. Washington, DC: World Bank.

¹² UNDP Regional Bureau for Europe and the CIS (1999a) *Central Asia 2010: Prospects for Human Development*. New York: UNDP.

¹³ Deacon, B. (2000) 'Eastern European Welfare States: the Impact of the Politics of Globalisation', *Journal of European Social Policy* 10 (2): 146-61.

marginally to the identified differences between the trajectories of the social security systems, which remain mainly due, directly or indirectly¹⁴, to the internal conditions.

In what concerns the influence of the integration process, this is primarily felt through the transfer of the *acquis communautaire*, but, given the specific features of this area, the influence is comparatively lower. According to the European regulations on employment and social affairs, “there are no legal obligations to implement precise policy measures but a very important general obligation to co-ordinate the respective policies in order to develop a homogenous social framework in line with the principle and rules of the EU Treaty.”¹⁵.

The main channel through which EU accession influences the reform of the social security systems is the broader institutional reform. Even so, the effect is limited because:

- EU did not impose specific conditions to the social policy in the candidate countries. The main objective remaining nevertheless the removal of the legal and institutional barriers hindering the free movement of the labour force, in order to fulfil it, EU did not impose a formal convergence of the social security systems but expected their coordination;
- EU-15 itself does not promote a model of social security system suitable for the candidate countries. In this respect, the fuzzy character of the social criteria imposed to the candidate countries is simply a reflection of the heterogeneity within the EU (Leppik (2003))
- Finally, the mechanisms through which EU would have been able to impose a standard for social policies in the candidate countries are fairly limited¹⁶.

Quite on the opposite, the role of internal factors is widely acknowledged as decisive (Ferrera et al., (2003)). Nevertheless, no consensus exists on an optimal analytical framework of the differences between the social security systems. A transition from a lax social security system to a competitive one is difficult from political point of view, and the lack of a tendency of rapid convergence is very often motivated by the path dependency and political inertia, incl. at the level of the EU-15 countries (Hemerijck, (2002)), and even more so in the case of the ex-communist countries. On the other hand, some of the new socio-economic conditions sustain and even impose the reform of the social security systems. Firstly, the emergence of the new social problems generated by the process of privatisation and marketisation of the state companies lead to a significant growth of the social security expenditures and supplementary fiscal burden (Sengoku, (2001)). Secondly, quite often, the reform of the social security systems does not appear as necessary by itself, but it is a result of reforms implemented at other components of the institutional framework¹⁷. Without any doubt, the

¹⁴ One of the most relevant examples in this respect is the reform of the pension system. Despite the fact that the WB promoted very actively the multi-pillar pension system, this was implemented only in few countries of the region. According to Mullar (2002), the WB could actually influence the reform of the pension systems only in countries that have high external debt, pushing these countries into the adoption of structural reforms. This explains why countries as Czech Republic and Slovenia did not implemented significant reforms, contrary to the case of Hungary. The bottom line is that the WB ability to influence reforms is strongly dependent on the internal conditions.

¹⁵ European Commission, *Guide to the Negotiation*, Ch. 13 “Employment and Social Policy” [<http://europa.eu.int/comm/enlargement/negotiations/chapters/negotiationguide.pdf>]

¹⁶ Such mechanisms certainly exist, for example through the program CONSENSUS, launched in 1995 as specific instrument for improving the cooperation between EU and candidate countries at the moment of implementation of social security policies. It is worth mentioning that this type of programs is meant to build a consensus at the level of EUROPE with regards to promotion of adequate social policies, rather than speeding the competition towards a certain model.

¹⁷ For instance, in Poland the fundamental reform of the social security system was inner to the reform of the local administration, as well as of the reform of education system starting in 1998 (Szatur-Jaworska, (2001)).

reform of the social security systems was influenced by the agenda of the political parties competing for the political power (Kitschelt (2001)).

In the Czech Republic, the main parties shaping the political landscape are the Social-Democratic Party (CSSD), the Liberal Party (ODS) and the Christian Conservative (KDU-CSL). In this case, the willingness of the liberal party to adopt liberal policies in the field of social protection is limited by the policies of other two parties that promote the idea of a protectionist state. In, the conservatory coalition FIDESZ-MPP-MDF is competing with the Democratic Party MSZP. The two parties claim each other responsible of the decline in the social protection expenditures, in a debate that actually led to the alternation of the two as ruling parties. Finally, in Poland the Social-Democratic Party SLD (SLD-UP after 2001) held the dominant position in the national political landscape, so it can afford promoting more liberal social policies even benefiting from capturing more of the supporters of liberal and conservative parties, without risking losing much of its own.

1.2.2.2 A classification of the main stages of the social reforms pre-and post-adhesion

In a nutshell, three distinct stages in the evolution of the social policies are identified in the literature¹⁸:

- **Stage 1**

At the beginning of the transition the social policies were designed to answer on the spot and even to anticipate the negative social consequences of the emergence of the market mechanisms. The crucial phenomenon in this respect was the emergence of the unemployment and the implicit reduction of the real revenues, given the social structures totally unprepared to cope with the risks inner to a market economy. This situation was more or less anticipated¹⁹. Typical for this stage is the fact that initially most of the transition countries adopted generous unemployment benefit schemes, but is only after democratic election of the new governments at the beginning of 1990, that significant changes in the social policies have been introduced.

Therefore in the first stage of the transition, economic reforms have been introduced without being accompanied from the very beginning with appropriate social support schemes (Wagener (2002)). Lacking a coherent long-term strategy, the countries of the region had to rely on an ad-hoc, incremental and reactive approach of social development, particularly of emergent issues as unemployment, social inequality or poverty (Deacon (2000) Ferge (2001a)).

- **Stage 2**

In this stage, first signs of difference appeared between the stances of national economies in the region as well as between the social policy reaction to the inherent tensions that resulted from the economic development. Institutional aspects had their negative impacts as well, despite the fact that they were expected to self adjust to the market. In particular we mention the issues of tax collection, as affecting the main source of financing the social policy expenditures.

An economic occurrence with particular impact on the social expenditures was the inflation that eroded and restructured the revenues, with pervert effects on the implementation of market mechanisms. Fortunately, in most of the countries of the region the inflation was kept under control by the mid '90ties. As well, the level of unemployment benefits was reduced as

¹⁸ Manning, N (2004) "Diversity and change in pre-accession Central and Eastern Europe since 1989", Journal of European Social Policy 14 (3)

¹⁹ Ellman, M. (1989) Socialist Planning, 2nd edition Cambridge: Cambridge University Press., i.a

proving unsustainable. At the middle of the last decade, the candidate countries reoriented towards encouraging the investment in the first run, diminishing in the same time the level of social protection.

The attempts of emulating basic features of the EU policies is to be found in the choice that most of the countries made between the social-democracy and the corporate management systems. The specificity of the Central and East-European countries in the field of social security lies in the fact that the transition from the previous communist system, based on high level of redistribution, was a process influenced more by the international organisations, IMF of WB, than by the wish of emulating the classical European models (Deacon (2000)).

Nevertheless, even at this stage, the social security systems show a dual character, which most of the population benefiting from quasi-free services, limited in scope and quality, while the richer layers of the society have access to high-quality, expensive services. Moreover, in this stage, even in the countries that resumed the economic growth, a decline in the level of poverty followed much later. The rising social inequality is a feature of the area. The poverty is due to a very low level of wages for low skilled workers and emergence of an undercapitalised new private sector and to lower unemployment benefits. Moreover, the negative demographic trends generate supplementary pressure on the budget leading to a steep decline in real pensions and pushing another layer of the population into poverty.

- **Stage 3**

The third stage in the transformation of the social systems was marked in 1998 by two major inflexion points: 1. five of the countries of the region reached the levels of GDP from before 1989 and 2. the economic crisis in Russia and satellite countries generated a peak in the levels of poverty, social inequality, inflation and unemployment. In this stage as well, the clearer economic prospects of economic integration for the most of the countries in the region stimulated more sustained efforts of harmonisation between social protection systems in these countries and the European ones, so that after the adhesion, most of those systems are within the margins of the European ones.

Nevertheless, a number of discrepancies exist, in particular in what concerns the social inequality between different categories of population as well as between regions.

The main trends emergent from the mid '90, amplified and deepened, namely:

- *Slow withdrawal of the state from the management of social protection specific activities:* elimination of several types of subventions on basic goods and services, privatisation and marketisation of a part of health and social insurance services, incentives for the NGOs;
- *Institutional separation of the social security budgets:* social security budget is separated from the state budget, pension funds are separated from the health insurance budgets; the social protection policy is implemented by a number of independent bodies, while the power and responsibilities of the local administration institutions were extended.

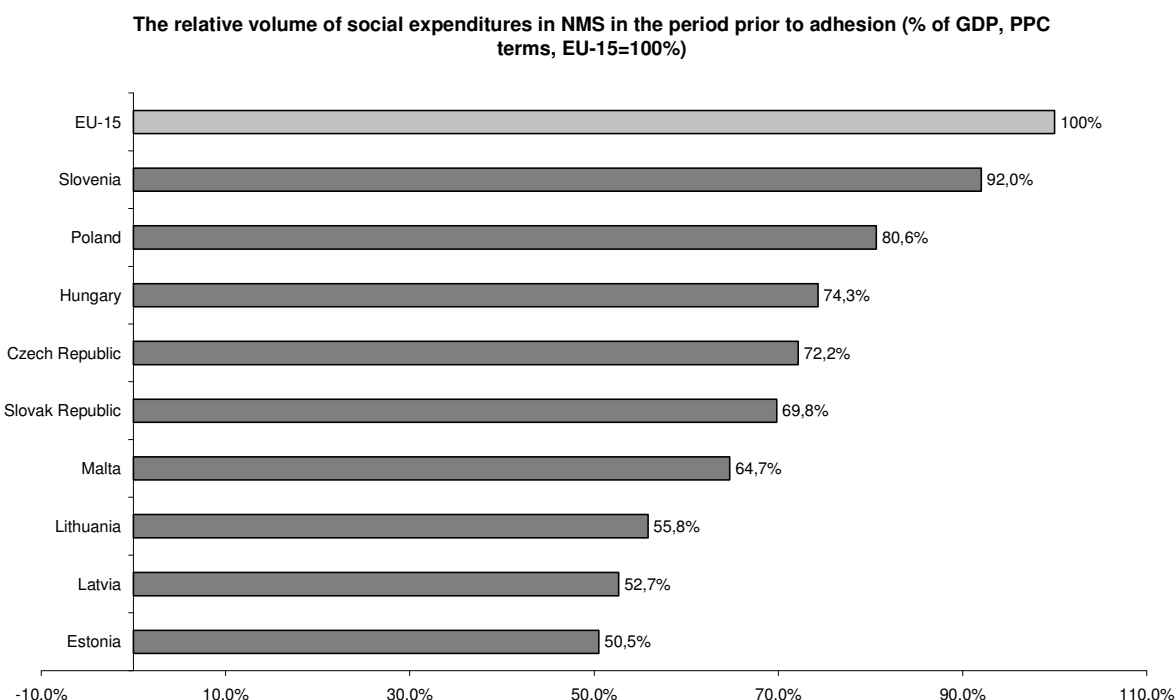
The reforms adopted in this period aimed at elimination of the state monopoly, stimulate the growth in the number of services providers, and decentralise the system administration (Ferge (2001a)). Nevertheless the reform had negative effects as well, especially in a growth in inequality and transfer of social responsibilities towards families, especially towards women, fuelling further the negative demographic trend.

1.2.2.3 The analysis of the main social indicators at the moment of adhesion

- **The expenses of the social security budget**

In comparative PPP terms, the level of expenditures with social protection per inhabitant were in the NMS immediately previous to adhesion significantly below those in the EU15 (see figure 1.11)

FIGURE 1.11



Source: Authors' calculations using EUROSTAT data (data for 2003; 2002, 2001 in same cases)

Nevertheless, a certain tendency of convergence in the levels of social security expenditures towards the west European levels (around 28% of the GDP), could be observed. Otherwise saying, the new member states make efforts to transpose the European social model, although at lower levels of revenues. The tendency of convergence speeded up in the few years prior to the integration, as before that, during 2000-2006, there was no change in the share of the social protection expenditures in the GDP, nevertheless higher than in Ireland and Southern EU countries.

Secondly, structural changes took place at the level of social protection expenditures in order to respond to the emerging social needs. While at the beginning of the '90ties "the direct expenditures with social protection and unemployment benefit were still covering a minor part of the total social security budget" (European Commission (2002)), around 2000, NMS started to spend increasingly more on social insurance schemes²⁰ as social assistance, family support, or alternative models of unemployment benefits (Ferge (2001b))²¹. Nevertheless, similarities as well as divergence can be observed in the systems of social protection in those countries. We will shortly overview the main elements of the system – retirement pensions, sickness and maternity allowances, social support schemes and unemployment benefits.

1) Retirement pensions

²⁰ excl. pensions and health.

²¹ with the notable exception of Hungary, where the reform of the social assistance in 1998 implied actually a decline in the incomes of the poor and the unemployed.

Significant differences exist between Hungary and Poland on one hand and Czech Republic and Slovenia on the other. Hungary and Poland introduced multi-pillar pension schemes, the second pillar being, according to the recommendations of the WB, as well compulsory but privately financed. Czech Republic and Slovenia maintained the traditional system of public pensions.

2) Health insurances

While in Czech Republic the health insurance is insured through universal public system, and is available for all the permanent residents, in the rest of the countries the health systems are financed by the contributions of employed population and covers the employee and his family. Poland introduced in 1998 a system meant to stimulate the competition between the suppliers of medical services, system conceived as a mixture of the German one (insuring free provision of basic medical services), the internal market one (then services are contracted and redistributed through a specific network of distributors) and the free market one (when the health services are directly contacted by the patients)²². The system was reviewed and partially recentralised by the social-democratic government.

3) Maternity support schemes

The most generous maternity support schemes are available in Hungary as specific medical assistance services as well as progressive financial support schemes for big family, in an amount proportional with the wage. In the other countries, only financial support for employed mothers is available.

4) Family allowances

In Hungary and Poland families under a certain poverty threshold receive a fixed allowance, while in Czech Republic and Slovenia these are calculated progressively according to the family revenue.

5) Unemployment benefits

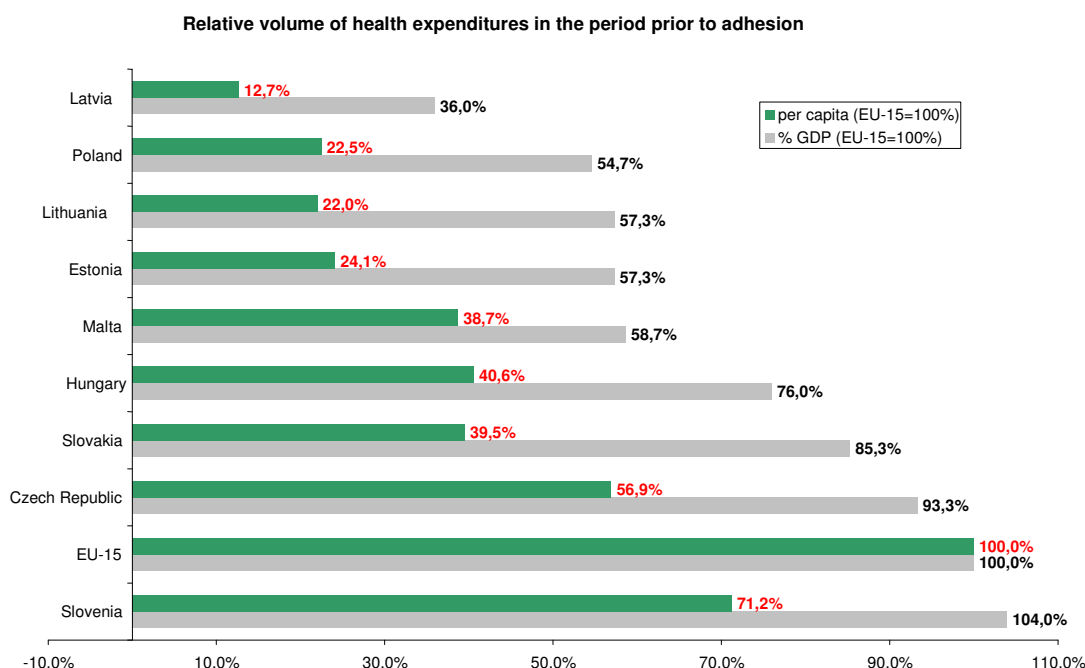
With the exception of Hungary, where the unemployment benefit system is managed by independent bodies, in the rest of the countries this was embedded to the general system of social security. The level of the unemployment benefit is proportional with the previous wage, aiming at maintaining constant the replacement ratio. In Poland, a fixed unemployment benefit was introduced in 1997, at a level of 35% of the average national wage.

• Public expenditures for health and education

A certain stability of the shares of public expenditures for health and education is observable since mid of the '90ties, for the EU-15 countries as well as for the NMS (see figures 1.12 and 1.13). This is an expression of the additional focus of the NMS towards addressing the short-term objectives, particularly the unemployment. On the other hand, many of these countries spend more of their GDP to the education, which is a guaranty of future convergence. It is to be expected that with the growth of the GDP, a higher share would be allocated to health as well.

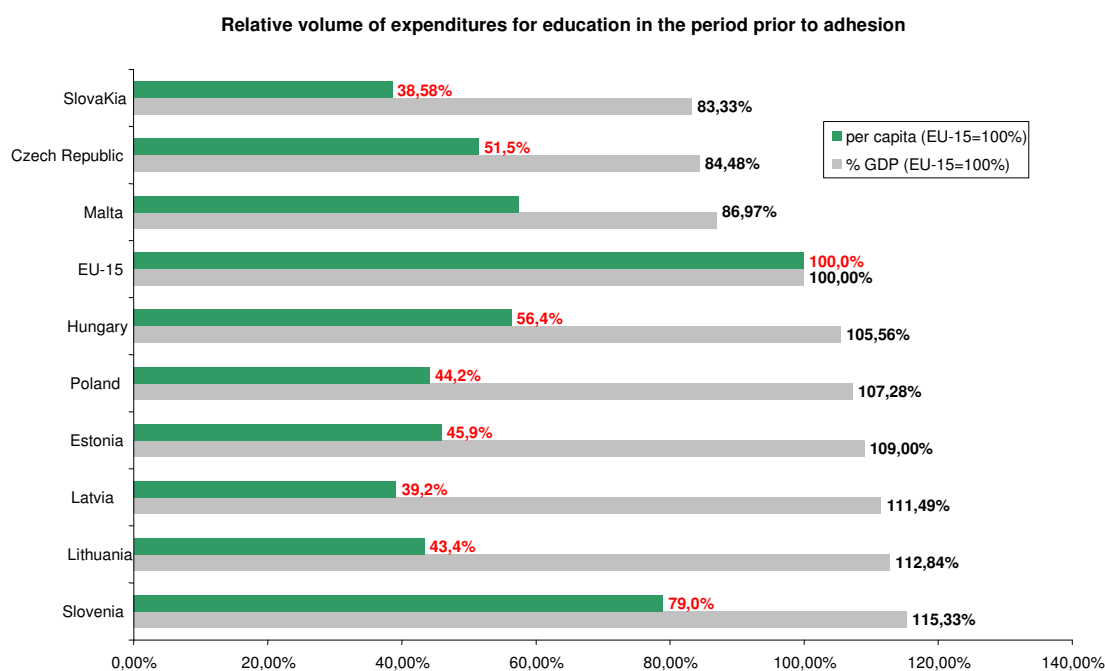
FIGURE 1.12

²² McMenamin & Timonen, 2002



Source: Authors' calculations using EUROSTAT data (data for 2003; 2002, 2001 in same cases)

FIGURE 1.13



Source: Authors' calculations using EUROSTAT data (2002)

Notes:

1. Health related expenditures cover sickness and invalidity compensations and other medical expenditures covered from the state budget
2. Education related expenditures are financed by the national budgets either through subventions to the education institutions or as financial support for the pupils and their family. Both are included in the above indicator.

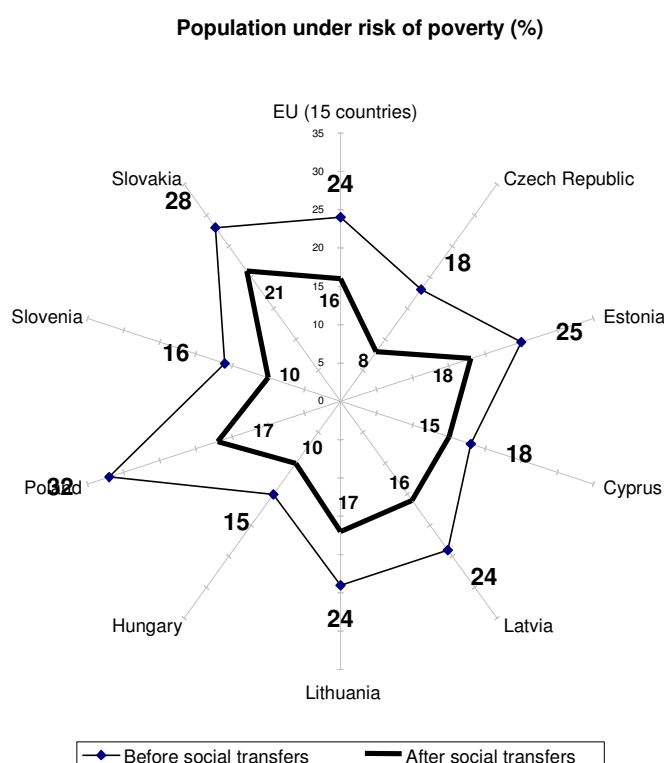
- **Poverty and social inclusion**

As in 2002 15% of the EU-25 population was under the risk of poverty (after social transfers)²³, with a spread from 10% and below in Czech Republic, Sweden, Denmark, Hungary and Slovenia and 20% and above in Ireland, Slovak Republic, Greece and Portugal²⁴. For a comparative view on the evolution of the share of population under poverty risk in NMS as compared with the UE-15 average see figure 1.14.

The poverty risk tends to be high for the unemployed, single parents, old households, and big families. There is well a connection between the pollution and social divide. The employment is obviously the key factor for the social inclusion, not only as source of revenue, but as well as promoter of social participation and personal development, contributing to maintaining adequate life standards at older age as well

Social transfers in the NMS tend to reduce the difference between the poverty levels within the group as well as between the NMS and the EU-15. In the same time the share of the population in poverty risk is lower, as well a statistical effect of low average revenues in these countries.

FIGURE 1.14



Source: EUROSTAT (data for 2002; 2001 or 2003 in some cases).

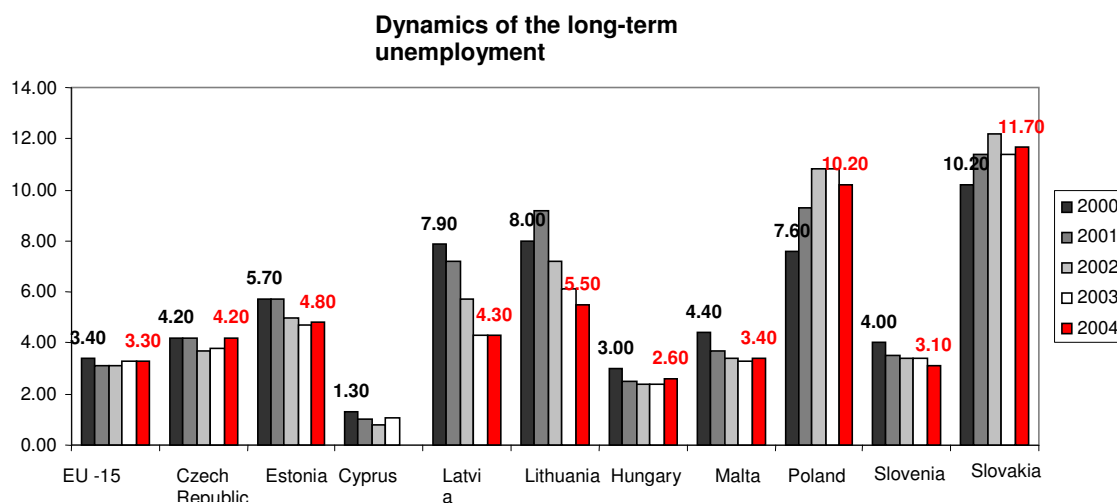
Note: Retirement and descendants' pensions are included as revenues and not as social transfers

²³ The population under risk of poverty is defined as the share of population with disposable income below the conventional threshold of 60 % of the national average revenue

²⁴ European Community Household Panel (ECHP)

An important share of the population has difficulties in finding work. The share of long-term unemployment remains basically constant between 1999 and 2003 at the level of EU-25 (around 4%), with only marginal changes brought by the accession (see figure 1.15). Moreover, except Poland and Slovakia (with shares of over 10%), the NMS recorded a deep decline in the long term in the pre-accession period, trend that seems to continue after the accession as well.

FIGURE 1.15



Source: EUROSTAT

The NMS face serious challenges, as they still need to restructure the industrial and agricultural sectors and, without counteracting the restructuring with appropriate social policies, the inequality and poverty levels might rise.

1.2.3 LEGAL AND INSTITUTIONAL ISSUES

1.2.3.1 Integration in the EU legal system: general aspects

It may be tempting to assume that the integration of the 10 new Member States, starting with May 2004, into the legal and institutional system of the EU, should not raise particular difficulties: before their accession, these countries went through a complex process of legal and institutional adjustment scrupulously monitored by the EU, involving both the transposition and actual implementation of the *acquis communautaire*, and requiring the setup and/or adjustment of internal legal and institutional arrangements for these tasks.

In June 1993, at Copenhagen, the European Council had established the political, economic and legal criteria that the candidate countries were to satisfy in order to obtain EU membership – usually referred to as “the Copenhagen criteria”: 1) stability of the institutions guaranteeing democracy, the rule of law, the protection of human rights and minorities; 2) existence of a functional market economy and the capacity to cope with competitive pressures inside the EU; 3) *capacity to assume membership obligations*, including adherence to the objectives of political, economic and monetary union (emphasis added).

Thus the Copenhagen membership criteria did not include a specific reference to the obligation to implement the *acquis* effectively, or the institutional/administrative reforms

required for fulfilling this obligation. However, in December 1995, the European Council, reunited in Madrid, made a first reference in this direction. In December 1997, the European Council, meeting in Luxembourg on the occasion of opening accession negotiations, established that, besides adopting the *acquis*, the candidate countries will have to prove capacity to effectively implement it. Finally, in June 2000, at Feira, the European Council declared that “[...] besides finding solutions to the problems raised in the course of the accession negotiations, the progress of the latter depends on the candidate countries incorporating the *acquis* in their national law, and especially on their capacity to effectively implement it.”²⁵

These conditions, and in particular the one referring to implementing effectively the *acquis* even before accessions, were qualified by enlargement analysts as insufficiently clear and quite arbitrary – especially considering that, within the Union itself, Community institutions are not empowered to evaluate *the capacity* to implement the *acquis* of the Member States, or to pass opinions about the organisation and functioning of their administration and judiciary, but only to check the implementation of, and compliance with the *acquis*. In practice, these conditions came rather to strengthen the position of the EU in the accession negotiations.²⁶ It is however undeniable that the support and monitoring instruments introduced by the EU in the course of preparations for accession (such as the various technical assistance programs, the direct and indirect means of communication established between the Commission and the administration of the candidate countries, the Commission’s annual reports on progress in the preparations for accession, the national plans adopted by the candidate countries for implementing the *acquis*, policy documents prepared in relation to the *screening* process, etc.) allowed at least the identifying of critical points, if not the shaping of defined standards for evaluating capacity to implement the *acquis*, and also brought about a special emphasis on building and strengthening the administrative and judiciary capacity in the candidate countries.

Thus it should not be surprising if, immediately after 2004, some of the new member States’ record of transposing the *acquis* was better than that of some older Member States – as we will show later in this chapter. It would be premature, however, to draw very optimistic conclusions based exclusively on these first facts. Throughout this chapter we emphasize that an essential distinction should be made between transposing and effectively applying the *acquis* – the latter being an important measure of the degree to which a country succeeds to integrate effectively and harmoniously in the Union’s policies and mechanisms.

Effective application of the *acquis* is a complex notion, involving not only the good performance of the legislative and administration, but also of the internal judicial system (as the actual implementation of the *acquis* relies to a good extent on the judiciary), the elimination of internal legal and procedural obstacles to an effective application of the *acquis*, etc. For a series of objective reasons, including the recent date of accession, it is difficult to evaluate the performance of the new Member States from this latter perspective – the time may have been too short for certain problems to surface, and in general, there are still very few comprehensive studies and sources of information on these aspects. At the same time, we emphasize that among the older member States themselves there is a high level of heterogeneity with respect to the organisation of the judicial systems and their effectiveness in applying the *acquis*. Not in the least, in many domains the relationship between EU and national law is in itself quite intricate, and often the application of the *acquis* relies on national procedures and remedies, with instances of harmonisation of the latter being very

²⁵ See Phedon Nicolaides (2001): “Effective Implementation of EU Rules: An Institutional Solution”, 36 *Intereconomics* 1, 14-19.

²⁶ See, e.g., Phedon Nicolaides (2003): “Preparing for Accession to the European Union: How to Establish Capacity for Effective and Credible Application of EU Rules”, in Marise Cremona, ed., *The Enlargement of the European Union*, Oxford University Press, pp. 45-105.

rare. These factors in themselves account for a good deal of the heterogeneity existent in the application of the *acquis*.

Some preliminary remarks about the EU legal system and the application of the *acquis* are useful before referring to the experience of the new Member States with transposing and applying the *acquis*. In what follows, we cover in a succinct manner the following aspects: the main sources of EC law; differences between these sources in terms of legal effects; the modalities available to the Community institutions for verifying compliance by the Member States with their obligations related to transposing and applying the *acquis*.

EU law (or the *acquis communautaire*) comes from **three main sources**:

- **primary law**, including the Treaties and other agreements of similar rank concluded among the Member States;
- **secondary law**, comprising acts adopted by the EU institutions based on Article 249 EC - regulations, directives, decisions, recommendations, opinions, communications, etc.; and
- **the jurisprudence of the European courts** (i.e., the Court of Justice of the EC (ECJ) and the Court of First instance of the EC (CFI)).

EU law covers *three main domains*:

- the **Internal Market**, based on the four fundamental freedoms of movement – persons, services, goods and capital –, which includes common policies in the areas of agriculture (the Common Agricultural Policy - CAP), environment, competitiveness and trade, monetary union, as well as cooperation on taxation and citizenship matters (First Pillar);
- the **common external and security policy** (Second Pillar);
- **Justice and Home Affairs**, which involves cooperation between policy forces and in criminal law matters (Third Pillar).

The First Pillar – Internal Market – is the most significant, and EU institutions exert legislative powers especially in this domain.

As to the **legal effects** of Community law, there are a series of distinctions to be made, which have important practical consequences.

Primary law (Treaties and similar agreements), **regulations**, and the **jurisprudence of the European Courts** (ECJ and CFI) all have **direct effect** at the level of the Member States – in other words, their provisions are part of the internal law of the Member States, without it being necessary to transpose them into national legislation. In EU terminology, the provisions of the Treaties and EC regulations “have direct effect and applicability”.

EC directives, instead, only establish common legislative objectives, thus leaving to the Member States the freedom to choose the precise forms and methods of transposing them into their national legislation (Article 249 EC). The Member States have the duty to transpose EC directives in a satisfactory manner within an established deadline.

Decisions, in particular those adopted by the European Commission, have **binding effect at individual level**, namely with respect to the Member States, bodies, companies and persons to whom they are addressed (see, for example, the Commission’s decisions in the area of EC competition law). Thus, decisions are distinct in this respect from Treaty provisions and EC regulations, in the sense that they establish obligations only at individual level, but they are similar to the latter in that they are binding in their entirety. At the level of the EU citizens, decisions have direct effects equivalent to those of EC regulations and Treaty provisions.

By contrast, **the recommendations, opinions, communications, etc.** issued by EU institutions in theory do not have binding effects on their addressees, their weight being rather of a political and „moral” nature. However, such acts produce **indirect legal effects** both at the level of the institutions that issued them (in the sense that they can be interpreted as political engagements of the latter, thus generating legitimate expectations at the level of the Member States and individual subjects) as that of the Member States, to the extent that the latter were consulted previous to their adoption and approved the content. For example, in the area of EC competition law, the Commission often publishes communications, notices, frameworks, guidance documents and letters addressed to the Member States, which establish criteria for the interpretation and implementation of different aspects of the EC competition rules. The main purpose of such acts is to offer guidance and clarity as to the Commission’s enforcement policy. The Member States are consulted on the content of these acts, and thus informally assume their content. In instances where some Member States do not agree on the content of such guidance, the Commission cannot impose compliance *per se*, but will have the opportunity to impose its position through decisions dealing with individual cases – which, in their turn, may be appealed to the ECJ.

It is useful to add a few remarks about the **direct effect doctrine** and the **primacy of EC law**, which have a notable practical importance for the Member States, companies and EU citizens alike.

In short, in EU terminology, **direct effect** means that certain EC rules can be directly applied by courts in the Member States, even if not transposed into national law. The ECJ set the foundations of the direct effect doctrine 40 years ago, through the *Van Gend and Loos* judgment.²⁷ This case established the right of Community citizens to rely on Community law (and its primacy) to challenge national rules that impede or obstacle the exercise of rights resulting from the former.²⁸

Initially, the direct effect doctrine was applied exclusively in relation to the so-called “negative obligations” imposed by EC law to the Member States – in other words, the obligation for the Member States not to adopt and apply measures hampering individual rights resulting from primary EC law (mainly the four fundamental freedoms of movement – for persons, services, goods and capital). In a second stage, the direct effect doctrine was extended to cover individual rights resulting from EC directives. In a third stage, the ECJ elaborated the difference between **vertical** and **horizontal direct effects**, the first referring to circumstances where citizens can rely on EC law to challenge state measures, and the latter applies to disputes among individuals.

The main criteria for determining whether an EC law provision has direct effect were established in the same *Van Gend and Loos* judgment, as follows: the provision must be *clear, precise, unconditional*, and able to *give rise to individual rights*. It is important to also remind in this context the principle established by the ECJ in *Francovich*,²⁹ according to which the Member States must compensate the individuals for damages resulting from breach of Community law through their own actions (or lack of action).

The **primacy of EC law** was introduced by the ECJ through the *Costa v. ENEL* judgment,³⁰ which established that EC primary law takes precedence over the internal law of the Member States, and empowered national courts to act accordingly. Similar to the direct effect doctrine, this principle was subsequently extended to comprise other sources of Community law – with the consequence that all EC provisions establishing rights and obligations, no matter of their

²⁷ Case 26/62, [1963] ECR 1.

²⁸ See Francis J. Jacobs (2004): “The Evolution of the European Legal Order”, 41 *Common Market Law Review*, pp. 303-316.

²⁹ Cases C-6 si C-9/90, [1991] ECR I-5357.

³⁰ Case 6/64, [1964] ECR 585.

source, will take precedence over national law. Moreover, through the *Simmenthal* judgment,³¹ the ECJ established that national courts are obliged to disapply national rules that are in conflict with EC rules – without it being necessary that the latter be annulled by constitutional courts. One should note, however, that the primacy of EC law is not absolute: it applies only in relation with EC rules that have direct effect, there are obstacles to its application resulting from national procedures, and national courts are not obliged to apply EC rules *ex officio*.

This short overview allows us to draw a few conclusions relevant for this study:

1) the notion of “implementation of the *acquis*” is in reality more narrow, covering in particular measures adopted by the Member States in order to transpose EC directives into national legislation (though, as we shall discuss in what follows, this is not an easy task, given the impressive number of EC directives and their accelerated rhythm of adoption);

2) the notion of “application of the *acquis*” is actually broader, and in this respect national courts play an important role. Implicitly, when we discuss about institutional capacity to implement the *acquis* in the new Member States, we should refer to only to the attributions, resources and qualification of administrative bodies, but also those of the national courts.

Before opening the discussion about specific implementation issues in the new Member States, it is useful to briefly mention the modalities through which EU institutions can verify compliance by the member States with their obligations related to transposing and applying EC law, as well as the sanctions available in cases of breach of these obligations. P. Nicolaides (2003)³² identifies 8 principal methods through which the EU can control, and respectively influence in an informal way, compliance with these obligations:

1. The publication of periodical reports on the transposition of EC directives in the Member States.
2. The publication of the results of opinion polls among the business community about specific problems and obstacles existent in some Member States.
3. Encouraging individuals and companies to use the channels available for challenging national law and administrative acts in breach of EC law.
4. Inspections by Commission staff or the staff of various EC agencies.
5. The opening by the Commission of procedures for non-compliance with obligations resulting from EU membership, based on Articles 226 and 228 EC.
6. Evaluations performed by the Commission of the state of play in different areas of the Internal Market.
7. Monitoring and coordination of national economic policies (“the Luxembourg process”).
8. Informal modalities of evaluating and monitoring among the Member States („peer pressure”, „peer review”) practiced in the context of the informal committees and “working groups” organised at EU level.³³

³¹ Case 106/77, [1978] ECR 629.

³² See *supra* note no. 2.

³³ See, for example, *Commission Recommendation of 7 December 2001 on principles for using SOLVIT – The Internal Market Problem Solving Network*, OJ L 331 [2001]. This mechanism consists of establishing “national points of contact” available to individuals and companies affected by problems related to the application of the *acquis*-ului in the Member States. These contact points, relying on personnel from the national administration, periodically communicate among each other and with the Commission in an informal cooperation network. Periodical meetings at EU level are organised, where members can discuss informally modalities to counteract certain infringements of EC law.

In what follows we briefly describe each of these methods, which are useful sources of information on the performance of the new member States in transposing and applying the *acquis* following accession.

The first method involves the periodical publishing by the Commission of reports on the transposition of the *acquis* in the Member States (*Single Market Scoreboards* – see below). Occasionally these reports include the results of opinion polls carried out among the business community on obstacles encountered on the Internal Market – the second method mentioned above. The third method consists of establishing in the Member States information points for companies and citizens concerning the rights resulting from EC law and the remedies available for their protection. The fourth method implies the carrying out, by Commission staff or staff of EC agencies, of inspections to verify compliance with, and the application of, EC rules addressing certain specific domains. For example, DG COMP officials can perform inspections (the so-called “dawn raids”) at the headquarters of companies under investigation for possible infringements of EC competition rules (in particular cartels), and even at the homes of company managers, and have the power to seize proof of infringements of Articles 81 and 82 EC. Commission staff also performs periodical inspections for financial control purposes, for preventing fraud, for verifying compliance with EU standards on health and food safety.³⁴ The non-compliance procedures based on Articles 226 and 228 EC shall be discussed in some more detail in what follows. The sixth method, consisting of periodical evaluations by the Commission of the state of play in different areas of the Internal Market, implies the use of different evaluation methodologies, specific to each domain. The Commission’s recommendations following such evaluations are not binding for the Member States, at least in principle, although of course they will have a certain practical impact on the latter. The seventh method, or the so-called “Luxemburg process”, refers to monitoring and coordination of economic and employment policies in those areas where there is no *acquis* establishing common policy objectives and modes of coordination. The eighth and final method does not need further explanations, its functioning being quite self-evident, but it may be necessary to mention that it gained in importance in the context of the current debate within the EU on new modes of governance and the so-called “method of open coordination”.³⁵

1.2.3.2 Transposition of the *acquis*

In the context of performing its control attributions on the application of the *acquis* in the Member States, the Commission publishes periodically reports on the transposition of EC directives – the *Internal Market Scoreboards*.³⁶ The Commission publishes similar periodical reports on the application of the *acquis* by the administration and courts of the Member States – the *Annual Reports on Monitoring the Application of Community Law*.³⁷ The main purpose of such reports is to identify internal obstacles to the effective application of the *acquis*, though the Commission’s recommendations are not binding – here we could probably talk

³⁴ For a more detailed description of the way in which inspectors from the Commission’s Food and Veterinary Office control compliance with the standards on food safety, see the Commission’s Memorandum of 24 April 2003 (MEMO/03/88), available at <http://europa.eu.int/rapid/pressReleases>.

³⁵ For a detailed examination of this evolution, see, e.g., Alasdair R. Young (2005): “The Single Market – A New Approach to Policy”, in Helen Wallace si William Wallace, eds., *Policy-Making in the EU*, Oxford University Press, 5th edition, pp. 94-110.

³⁶ Full texts of recent decisions are available on-line at http://europa.eu.int/comm/internal_market/score/index_en.htm.

³⁷ The Reports are available on-line at http://europa.eu.int/comm/secretariat_general/sgb/droit_com/index_en.htm. The most recent version available dates from 2003 –meaning they do not include information about the New Member States.

about a “psychological effect”, to the extent that the publication of identified problems affects the image of the Member States in question. On the other hand, it is hoped that the periodical publication of best practices in some Member States will be a model and a stimulus for the other.)

Recent issues of the *Internal Market Scoreboards* show that the older Member States themselves have problems and delays in the transposition of EC law. This situation is not new – and this is the reason why the Commission called the EU-15 at consecutive meetings in Stockholm (2001), Barcelona (2002) and Brussels (2003, 2004), to improve their performance in transposing the *acquis*, and established as a general objective the reduction of annual deficit in transposition to 1.5%.

Notwithstanding this, in May 2004, the EU-15 average deficit in the transposition of Internal Market directives was of 2.2% (standing for 9% of the total number of EC directives in this domain, or 134 directives).³⁸ In 2004, only 5 countries from the EU-15 group (Denmark, UK, Spain, Ireland and Finland) managed not to go above the established deficit threshold of 1.5%. At the other end of the deficit scale was France, which in 2004 did not comply with the time limit for the transposition of 62 directives (a transposition deficit of 4.1%).

In so far as the new Member States are concerned, in May 2004 the real situation in this respect was still insufficiently clear, given that measures adopted for the transposition of EC directives were notified to the Commission after the date of accession and still needed to be evaluated by the latter (immediately after May 2004 the Commission received from the EU-10 thousands of notifications in this sense). Moreover, the fact that measures adopted for transposing a directive were notified does not necessarily mean that the transposition is satisfactory – following evaluation, the Commission could recommend their modification, or the adoption of supplementary measures. Taking these possibilities into account, the average transposition deficit for the EU-25 (comprising both older and new Member States) was of 7.1%. Some of the countries in the EU-10 group declared a high transposition deficit (for example, Slovakia reported 27.9% deficit, Poland 16.8%, the Czech Republic 10.7%), while others, according to their own declarations, had lower deficits than the EU-15 average (Slovenia 1.8%, Lithuania 1.2%).

It is remarkable that in June 2005 – one year after accession – the average transposition deficit of the EU-15 decreased by only 0.1% (i.e., from 2.2% in 2004, to 2.1%), whereas that of the EU-25 decreased from 7.1% to 1.9% - this being the second-best result since 1992, after that obtained in 2002.³⁹ This improved performance is to a large extent due to the new Member States, which performed exceptionally over the first year of membership in terms of transposition of EC directives. In 2005, the average transposition deficit of the EU-10 was of 1.7%, and countries like Lithuania, Hungary and Slovenia were even at the top of the EU-25, each with a transposition deficit of only 0.7% (followed by Denmark, Finland, Malta, Germany, Spain, Slovakia, Sweden and the UK, all with a transposition deficit under 1.5%). Several countries in the EU-10 group managed to improve in a spectacular way their transposition performance after May 2004: Slovakia reduced the transposition deficit from 27.9% in May 2004 to 1.4% in June 2005, Poland from 16.8% to 1.7%, and the Czech Republic from 10.7% to 3.6%.

The Commission estimates⁴⁰ that several Member States managed to improve their transposition performance by following the *Recommendations on transposition of Internal market directives in the national law*.⁴¹ In this Communication, the Commission suggested to the Member States, *inter alia*:

³⁸ See *Internal Market Scoreboard* No. 13 (July 2004).

³⁹ See *Internal Market Scoreboard* No. 14 (July 2005).

⁴⁰ See *supra*, at p. 10.

⁴¹ OJ L 98 [2005].

- to choose the procedures and institutional models related to the transposition of the *acquis* that are most suitable for their internal context;
- to avoid adopting internal measures that are not strictly necessary for transposing the *acquis*, or even hamper attaining the objectives established by the latter;
- to establish an internal system for permanent monitoring and policy coordination regarding the transposition of the *acquis*;
- to cooperate closely with the national, regional and local legislative bodies involved in transposing the *acquis*.

It is also useful to mention that in the following months the Commission will draft a Report on how these recommendations were actually put in practice, and proposing further improvements, exemplified through best practices identified in the Member States.

When Member States do not transpose EC directives within the established deadline, or transform them in an unsatisfactory manner, the Commission can open **sanctioning procedures for breach of the obligations related to EU membership**, on the basis of **Article 226 EC**. As mentioned above, this procedure is one of the main EU methods of administrative control over the transposition and application of the *acquis* in the member States.⁴² The procedure involves two stages: the preliminary stage, where the Commission issues a letter of formal notice to the member State concerned regarding a possible breach of its obligations related to transposing and applying EC directives, giving to the latter the possibility of submitting observations and further information relevant to the case. The purpose of this procedural stage is, on the one hand, to clarify if there are sufficient grounds for opening the formal procedure, and on the other hand, to offer to the Member State concerned the opportunity to remedy the situation without it being necessary to go to the formal procedure. The first stage ends either with the case being closed after reaching a satisfactory solution through negotiations, or with the Commission triggering the second – formal – stage of the procedure by issuing a reasoned opinion.

There are a number of exceptions from the scope of application of the sanctioning procedure based on Article 226 EC, as follows:

- circumstances where the administrative procedure is not necessary, as a direct action can be introduced before the ECJ;
- separate administrative and judiciary procedures are applicable in the area of EC competition law enforcement (especially with respect to state aid or the regime applicable to public companies enjoying special rights);
- cases where part of the control and monitoring attributions of the Commission were transferred to the Council, such as, for example, the control of public debt and budgetary deficits in the context of the EMU.

In practice, the scope of application of this sanctioning procedure is also narrowed, first, by the gradual introduction of speedier and more direct administrative control in certain domains (such as air transport, health, public procurement), and second, through the emergence of informal control and cooperation networks established at the level of the Member States (for example, the SOLVIT centres⁴³).

⁴² For a detailed analysis of this procedure, see Alberto J. Gil Ibanez (2004): “The ‘Standard’ Administrative Procedure for Supervising and Enforcing EC Law: EC Treaty Articles 226 and 228”, 68 *Law and Contemporary Problems* 135.

⁴³ See *Commission Recommendation of 7 December 2001 on principles for using SOLVIT – The Internal Market Problem Solving Networking*, OJ L 331 [2001].

The second stage of the sanctioning procedure based on Article 226 EC concludes with the adoption by the Commission of a decision addressed to the member State concerned. In cases of non-compliance with such decisions, the Commission can introduce a direct action based on Article 228 EC before the ECJ. When the ECJ finds a breach of the obligations related to transposing and applying EC directives, it issues an order addressed to the Member State in question requiring it to remedy the situation. Non-compliance with such an order may lead to pecuniary sanctions (fines). The Commission published two Communications related to the application of Article 228 EC and the methodology for calculating the related fines.⁴⁴ On the basis of these Communications the Commission retains a discretionary power to select the cases in which to formulate direct actions based on Article 228 EC and on establishing the quantum of the related sanctions (fines). The ECJ can modify the quantum of the fines proposed by the Commission, but otherwise its influence in this area is relatively low, as it can review only those cases where the Commission opted for formulating direct action against the member State in question.

In the Opinion delivered in the *Commission v. Spain* case,⁴⁵ Advocate General Mischo was very critical on the discretionary manner in which the Commission chooses to use this instrument - the Commission retains the right to select the cases where to trigger a sanctioning procedure according to criteria that are insufficiently clear and precise; moreover, there is no formal deadline for compliance with the ECJ judgments in this area – date after which fines would start being calculated. These issues were subsequently examined by a working group composed of ECJ members, which proposes a series of reforms of the Article 226 and 228 EC procedures, to be included in the Constitutional Treaty. The European Convention took over only some of these reform proposals, such as: to eliminate the administrative stages preceding the formulation by the Commission of a direct action for non-compliance with the obligations related to transposing the *acquis*, and to merge the Article 226 and 228 EC procedures. Obviously the fate of these reforms will depend on the outcome of the current debate on the future of the European Convention.⁴⁶

We remind in this context that UE companies and individuals have the possibility to formulate *damage actions* against the Member States for non/compliance with the obligations related to transposing and applying the EC directives. Such actions can be presented before the national courts, and will follow the relevant national procedures. According to the principle established by the ECJ in *Francovich and Bonifaci v. Italia*,⁴⁷ the Member States are liable for damages resulting from non-compliance with their Treaty obligations. In *Factortime*⁴⁸ the ECJ established that the Member States are obliged to ensure the availability in their legal systems of adequate and efficient remedies for damages resulting from the breach of rights established through EC law.

In the context of the *Internal Market Strategy* for the period 2003/2006,⁴⁹ the Commission asked the Member States to intensify their efforts to improve the transposition performance, so that the number of sanctioning procedures based on Article 226 EC be reduced by at least 50% until the year 2006. By the same token, in its *Communication on improving the monitoring of the implementation of Community law*,⁵⁰ the Commission established a number of priorities in the application of the sanctioning procedure, as following:

⁴⁴ *Commission Communication of 21 august 1996 on the application of Article 228 EC*, OJ C 242 [1996], and *Commission Communication of 28 February 1997 on the methodology for calculating the fines envisaged by Article 228 TCE*, OJ C 63 [1997].

⁴⁵ Opinion of 12 August 2003, delivered in Case C-278/01, OJ C 245 [2001], p. 16.

⁴⁶ For further details, see Alberto J. Gil Ibanez (2004), *op. cit.*

⁴⁷ Joined Cases C-6 and 9/90, [1991] ECR I-5357.

⁴⁸ Case C-213/89, [1990] ECR I-2433.

⁴⁹ COM (2003) 238, 7 May 2003.

⁵⁰ *Commission Communication on Better Monitoring of the Application of Community Law*, COM(02) 725 final.

- breach of obligations resulting from EC rules that undermine the rule of law;
- breach of the principles regarding the primacy of EC law and its uniform application;
- breach of human rights and other fundamental freedoms established by EC law, such as the right to vote;
- infringements that undermine the efficient functioning of the EU legal system;
- infringements of the exclusive competencies of the EU in domains such as the commercial policy and other common policies;
- repeated infringements in the same Member State over a given period of time, or repeated infringement of the same EU rules;
- infringements of EC law with cross-border effects, which make it more difficult for EU citizens to exercise their rights resulting from EC law;
- non-compliance with ECJ judgments that are related to infringements of EC law;
- breach of obligations related to the timely and correct transposition of EC directives, which may deprive considerable parts of the public of access to EC law.

As the June 2005 issue of the *Internal Market Scoreboard* shows, however, the number of sanctioning procedures opened over the period 2003-2005 against countries in the EU-15 group did not decrease much (for example, at the mentioned date the Commission had on the role 152 sanctioning procedures based on Article 226 EC against Italy, 117 against France, 113 against Spain, and 105 against Germany. At the same time, one year after accession, the EU-10 already started to have implementation problems: for example, until June 2005 the Commission already opened 13 sanctioning procedures against Poland, and by the same date only 4 of the new Member States (Lithuania, Estonia, Hungary and Slovenia) had less than 5 sanctioning procedures opened against them.

The Table below lists some of the more recent examples of sanctioning procedures against the EU-10 (except Cyprus and Malta, whose experiences are perhaps less relevant for the case of Romania).

Country	Subject of the sanctioning procedure	Date	Stage of the procedure
Poland	- non-transposition of Directive 2002/92/CE (intermediation in the insurance domain)	20/07/2005	Closed
	- unsatisfactory transposition of Directive 2000/59/CE (harbour installations for ship waste and fuelling residues)	12/4/2005	reasoned opinion (stage II)
	- non-transposition of Directive 2003/55/CE (Gas)	13/10/2004	letter of formal notice (stage I)

	- non-transposition of Directive 2003/54/CE (Electricity)	13/10/2004	letter of formal notice (stage I)
Czech Republic	- non-transposition of Directive 98/84/CE (legal protection conditional access services)	20/07/2005	Closed
	-non-transposition of Directive 75/117/CEE (equal wage treatment between men and women)	13/07/2005	reasoned opinion (stage II)
	- non-transposition of Directive 80/723/CEE on transparency of financial relations between state and public companies	5/07/2005	reasoned opinion (stage II)
	- non-transposition of Directive 2000/43/CE (non-discrimination by race and nationality)		reasoned opinion (stage II)
	-non-transposition of Directive 2000/78/CE (equal treatment re. Work conditions)	20/07/2005	reasoned opinion (stage II)
	- non-transposition of Directive 2003/54/CE (Electricity)	20/07/2005	letter of formal notice (stage I)
		13/10/2004	
Slovakia	-non-transposition of Directive 96/48/CE (interoperability of transeuropean railway transport systems)	5/07/2005	reasoned opinion (stage II)
Hungary	- non-transposition of Directive 2003/54/CE (Electricity)	13/10/2004	closed
Slovenia	- non-transposition of Directive 2002/85/CE (installment of speed limit systems for certain categories of vehicles)	20/07/2005	reasoned opinion (stage II)
	-non-transposition of Directive 2004/3/CE (CO2 emissions and fuel consumption for vehicles in category N1)	13/07/2005	reasoned opinion (stage II)

	- non/transposition of Directive 2003/55/CE (Gas) - non-transposition of Directive 2003/54/CE (Electricity)	13/10/2004 13/10/2004	letter of formal notice (stage I) reasoned opinion (stage I)
Lithuania	-non-transposition of Directive 2003/55/Ce (Gas)	13/10/2004	letter of formal notice (stage I)
Latvia	- non-transposition of Directive 2003/55/CE (Gas) - non-transposition of Directive 2003/54/CE (Electricity)	13/10/2004 13/10/2004	letter of formal notice (stage I) letter of formal notice (stage I)
Estonia	- non-transposition of Directive 2003/55/CE (Gas) - non-transposition of Directive 2003/54/CE (Electricity)	13/10/2004 13/10/2004	letter of formal notice (stage I) letter of formal notice (stage I)

Source: General Secretariat of the Commission

(http://europa.eu.int/comm/secretariat_general/sgb/droit_com/index_en.htm#infractions)

For information purposes, in table 1.11 below we indicate the percentage of sanctioning procedures opened against the EU-15 in 2003, by areas of the *acquis*. Such information is a useful indicator as to which are the most „problematic” areas of the *acquis* in terms of transposition into national legislation, at least in the experience of the older Member States.

TABEL 1.11

Area of the <i>acquis</i>	Percentage of the overall sanctioning procedures opened in 2003
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Environment	46.6%
Internal Market	17.4%
Taxation and customs union	8.7%
Budget	5.5%
Energy and transport	4.0%
Agriculture	3.2%
Justice and home affairs	3.2%
Labour and social law	3.2%
Health and consumer protection	2.4%
Enterprises	1.6%
Education and culture	1.2%
Fisheries	1.2%
Competition	0.8%
External relations	0.4%
Personnel and administration	0.4%
Legal service	0.4%

Source: *21st Annual Report on Monitoring the Application of Community Law*, COM(2004) 839 final, Annex A (situation by domain).

Before concluding this section we add a few remarks about the **safeguard clauses** in the Accession Treaties concluded with the 10 new Member States, respectively Bulgaria and Romania.⁵¹ As mentioned above, when Member States do not fulfill their obligations with respect to transposing and applying the *acquis*, the main instruments for sanctioning them is through Commission decisions or ECJ judgments (respectively, damages awarded by national courts to companies and individuals). Traditionally, the Treaties have not included provisions allowing other Member States to adopt retaliation measures, or withdrawing to the Member States certain benefits related to EU membership. Notwithstanding this, the Accession Treaties signed by the EU-10 and Romania and Bulgaria contain two categories of safeguard clauses.

The first is not a novelty, in the sense that such clauses have also been stipulated in the case of preceding enlargements, but were very rarely applied. This category of safeguard clauses foresees that, during the first 3 years following accession, any of the Member States (among either the elder or the new) can invoke -and be approved- temporary protection measures for their economic sectors in cases of particular hardships.

The second category, comprising the so-called „Internal Market safeguards”, were designed especially in view of the accession of the Eastern European countries. There was a perceived need for supplementary instruments, besides those already available in the Treaties, to intervene in cases where one of the new Member States were not to comply with its obligations in terms of implementing the *acquis* related to the Internal market.

In practical terms, the Internal Market safeguard clause can be invoked during the first three years following accession. The sanctions adopted on its basis – which may include even the

⁵¹ See Marise Cremona (2005): “EU Enlargement: Solidarity and Conditionality”, 30 *European Law Review* 1, pp. 3-22.

temporary reintroduction of border controls – can be applied for an undetermined period of time – to be more precise, until the new Member State(s) in question fulfils its obligations in this respect. The safeguard clause can be triggered by the Commission, on its own initiative or at the request of the Member States, when breach of Treaty obligations causes a sizeable negative impact on the Internal Market. It is significant to note the considerable discretion enjoyed by the Commission in the application of this type of safeguard clauses: consultation procedures with the European Council and/or the European Parliament are not foreseen (to be more precise, the European Council will be consulted only in relation to lifting the sanctions adopted on the basis of the safeguard clause, and no procedural guarantees were foreseen in relation to the procedure triggering the clause (though the Commission will also hear the Member States that are directly interested in the case).

1.2.3.3 Application of the *acquis* by national courts

1. Support from EU institutions in the application of the *acquis* by the national courts of the Member States

The preliminary reference procedure. National courts in the Member States can rely on the ECJ's support in the interpretation of EC rules that have relevance in the cases before them. Article 234 EC (*ex* Article 177 EEC) establishes that all national courts in the Member States, no matter of their position in the internal judicial hierarchy, have the right to address to the ECJ questions regarding the *interpretation* of Community law (*nota bene*: the questions must concern the interpretation of Community rules, and not their application to the specific factual circumstances of the case), through the so-called "preliminary reference procedure". According to Article 234(3) EC, the supreme courts (or the courts of last instance in the national judicial hierarchy) are even *obliged* to request preliminary rulings from the ECJ interpreting or validating the EC rules applicable to cases at the last stage of appeal.

Thus, the preliminary reference procedure is a modality to give support to the national courts in the application of the *acquis*, but at the same time, it is an important way to ensure consistency in the application of the *acquis* in the Member States. At present preliminary reference procedures account for about 60% of the ECJ's overall activities,⁵² being thus by far more numerous than direct actions based on EC rules. In essence, cooperation between the ECJ and national courts in the context of the preliminary reference procedure is one of the primary modes of developing and guaranteeing the proper application of the *acquis*. Direct actions, on the other hand, are in most cases initiated by the Commission, based on Articles 226 and 227 EC, for breach of obligations resulting from the Treaties or infringements of the Community law. In such cases the role of the EU citizens is indirect, to the extent that their contribution consists of informing the Commission of infringements or non-compliance with the *acquis*. Cases where the Member States initiate actions against other Member States are quite rare. Not in the least, there are also direct actions formulated by the EU citizens or by companies against the Member States for breach of individual rights arising from EC law, as well as actions contesting the validity of Community acts.

As already mentioned above, preliminary reference procedures can be classified in two main categories: "non-compulsory", and "compulsory".

⁵² Stacy A. Nyikos (2003): "The Preliminary Reference Procedure: National Courts Implementation, Changing Opportunity Structures and Litigant Desistment", 4 *European Union Politics* 4, pp. 397-419.

Non-compulsory preliminary references. The first category comprises requests for preliminary rulings coming from ordinary courts, which are entitled to judge themselves the necessity of opening such procedures according to the specific circumstances of the case before them. The ECJ is entitled to *reject* requests for preliminary rulings originating from ordinary courts only in exceptional circumstances, as follows:

- when the questions raised by the national court are not relevant, in the sense that, no matter what the response from the ECJ would be, it cannot change the outcome of the case;
- the questions regarding the interpretation of Community rules that have been addressed to the ECJ bear no connection to the factual situation of the case;
- the interpretation issue that was raised is only hypothetical;
- the national court did not make available to the ECJ all proof and legal arguments relevant for giving an adequate answer to the questions raised.⁵³

According to the *Rules of Procedure of the ECJ*,⁵⁴ the latter also reserves the right to issue orders closing preliminary reference proceedings that raise questions evidently identical to those that have been dealt with in previous ECJ ruling. However, this step can be taken only after having consulted the national court that initiated the procedure, hearing the parties, the governments that intervened on the case, the Commission, and in some cases, the European Council.⁵⁵ In practice there are cases where that national courts voluntarily withdraw their request, following informal consultations with the Court Registry. In the context of such informal contacts, the Court Register often indicates to the referring courts indications as to existent jurisprudence answering their queries, or even helps the referring courts to reformulate their initial questions. According to Article 20 of the ECJ Statute,⁵⁶ national courts are obliged to suspend proceedings in cases where a request for a preliminary ruling was addressed to the ECJ. In the legal system of some Member States the stay of proceedings means that the national courts literally cannot take any further steps until the ECJ pronounces its ruling. This is implicitly an obstacle in the cases where the reformulation of the original questions addressed to the ECJ might be advisable.⁵⁷

Compulsory preliminary references. In the early years of redevelopment of the EC legal system, the ECJ introduced through the *Costa v. ENEL* judgment⁵⁸ a mechanism for ensuring consistency in the application of EC law in the Member States, consisting of rendering requests for preliminary rulings by national courts of last instance compulsory in all cases involving the application of EC law. There are, however, a number of exceptions from this general obligation, as following:

- The so-called situations of *acte éclairé*, namely, where the same issues of interpretation have already been dealt with by the ECJ in preceding rulings.⁵⁹

⁵³ For further details about such situations, see Cases C-318/98 *Fornasar and Others* [2000] ECR I-4785, C 283/81 *CILFIT* [1982] ECR 3415, and C-355/97 *Landesgrundverkehrsreferent* [1999] ECR-4977.

⁵⁴ Full text available on the ECJ site, at <http://www.curia.eu.int/en/instit/txtdocfr/index.htm>.

⁵⁵ Article 104(3) from the Rules of Procedure of the ECJ.

⁵⁶ Full text available on the ECJ site, at <http://www.curia.eu.int/en/instit/txtdocfr/index.htm>.

⁵⁷ For a detailed discussion on these aspects, see David Edward (1999): "The Preliminary Reference Procedure: Constraints and Remedies", paper delivered in Bruges at a Colloquium on the reform of the EU judicial system (CCBE/College of Europe, Bruges, 19-20 November 1999, *Revising the European Union's Judicial System: Assessing the Possible Solutions Revising the Preliminary Ruling Mechanism*).

⁵⁸ ⁵⁸ Case 6/64, [1964] ECR 585.

⁵⁹ See, in this sense, Joined Cases C 28-30/62 *Da Costa and Schaake* [1963] ECR 31, and Case 283/81 *CILFIT* [1982] ECR 3415.

- The so-called situations of *acte clair*, or whenever the response to the questions of interpretation raised is self-evident, even if the issues were not addressed in preceding ECJ rulings.⁶⁰ Before concluding that they are confronted with an *acte clair* situations, the courts of last instance of the Member States must first make sure that the issues of EC law in question are interpreted in the same way by the ECJ and courts in other Member States. In this sense, the courts of last instance must take into account the following: a) the interpretation of EC provisions requires comparing the official versions in different languages of the latter; b) in EC law, terminology and concepts may not always have the same acceptance as in the national law; c) EC provisions must be interpreted against the background of the EC legal system as a whole, taking into account its objectives and actual stage of implementation.
- In cases of *interim proceedings* before national courts of last instance, the latter are not obliged to request an ECJ preliminary ruling as long as each of the parties involved in the case has the possibility to initiate “normal” proceedings.⁶¹

National courts can initiate the preliminary reference procedures either upon request of one of the parties involved, or *ex officio*, whenever retained necessary.⁶²

On the practical side, when initiating a preliminary reference procedure, the national courts forward the file of the case to the ECJ and fill in a *request form* containing the following elements:

- the description of the factual situation, mentioning all elements that are necessary in order to understand the interpretation question(s) raised;
- the description of the internal legal context relevant to the case;
- the description of the arguments invoked by the parties;
- a statement on the reasons that determined the national court to initiate the preliminary reference procedure;
- in so far as possible, a description of the position of the referring court on the interpretation and application of the EC rules in question;
- the questions of interpretation that are addressed to the ECJ.⁶³

As to the *effects* of ECJ rulings in preliminary reference proceedings, in principle such rulings are *binding* both for the court that initiated the procedure, as on the national courts of appeal that will be called to rule on the same case, but – and it is important to stress this aspect – they are not binding on other national courts that have similar cases on the role. In practice, the national courts have the possibility to avoid complying with the ECJ rulings: first, they could initiate a second preliminary reference procedure in the same case;⁶⁴ second, the national court may accept the interpretation given by the ECJ to the EC rules in question, but

⁶⁰ See Case 283/81 *CILFIT* [1982] ECR 3415.

⁶¹ Joined Cases 35/82 and 36/82 *Morson and Jhanjan* [1982] ECR 3732.

⁶² Case 126/80 *Salonia* [1981] ECR 1563.

⁶³ For supplementary details, see the ECJ Note on preliminary reference procedures originating from the national courts available at <http://www.curia.eu.int/en/instit/txtdocfr/index.htm>.

⁶⁴ *Cazul 29/68 Milch-, Fett- unter Eierkontor* [1969] ECR 165. Exista efectiv cazuri in care instanta nationala a optat pentru declansarea unei a doua proceduri de referinta prliminara – a se vedea spre exemplu, *Cazul C 157/84 Maria Frascogna v. Caisse des dépôts et consignations* [1985] ECR 1739.

reinterpret the factual situation in such a way so as to render the ECJ ruling inapplicable to the case.⁶⁵

In what follows we comment briefly on the importance of the preliminary reference procedure in the development of the EC legal system, and illustrate some trends concerning the number of request for preliminary rulings coming from courts in the EU-15 and the EU-10, respectively, as well as their distribution by subject-matter.

Although in principle the preliminary reference mechanism established in Article 234 EC places the ECJ in a position that is relatively inferior to that of a supreme court in a federal state (its influence remains only indirect, not having the authority of a court of last instance in a federal system), in practice it was the principal instrument to develop and extend Community law. For example, the primacy of EC law, the direct effect doctrine and the liability of the Member States for damages caused through breach of Community law and obligations, were all achieved through the preliminary reference procedure.⁶⁶

The data in Table 1.12 below indicate that, over time, the national courts became increasingly more “active” in the use of this instrument. The substantial rise of the number of requests for preliminary rulings inevitably affected the functioning of the ECJ: if in 1975 the average time necessary to obtain a ruling in a preliminary reference procedure was of 6 months, in 1988 the time necessary was of almost 2 years.⁶⁷ The setup in 1989 of the Court of First Instance did not solve the problem of the ECJ’s heavy workload, because the latter retains exclusive competence over direct actions initiated by EC institutions and the Member States, as well as over the preliminary reference procedure.

TABLE 1.12 The annual average no. of preliminary references in the EU-15

	Period			
	<u>1961-73</u>	<u>1974-80</u>	<u>1981-87</u>	<u>1988-94</u>
Belgium	2.2	10.3	12.7	19.7
Denmark	--	1.1	2.4	3.6
France	1.5	12.3	29.1	25.9
Germany	9.8	28.7	34.4	46.4
Greece	--	--	2.7	1.7
Ireland	--	1.3	1.6	1.4
Italy	1.5	12.4	9.6	23.6
Luxembourg	0.4	0.3	2	1.7
The Netherlands	3.6	14.3	17.9	19.7
Portugal	--	--	0	1.6
Spain	--	--	.3	5.3

⁶⁵See, for example, Case 131/79 *Regina v. Secretary of State for Home Affairs, ex parte Mario Santillo* [1980] ECR 1585. For a more detailed discussion on the second modality to avoid applying the ECJ rulings, see Stacy A. Nyckos (2003), op. cit.

⁶⁶ See, for example, George Tridimas si Takis Tridimas (2004): “National Courts and the European Court of Justice: A Public Choice Analysis of the Preliminary Reference Procedure”, 24 *International Review of Law and Economics* 2, pp. 125-145. Essential readings on the preliminary reference procedure and the relationship between the ECJ and national courts include: M.-M. Slaughter, A. Stone Sweet si J. H. H. Weiler (1997): *The European Court and the National Courts – Doctrine and Jurisprudence: Legal Change in Its Social Context*, Hart Publishing, Oxford; J. H. H. Weiler (1994): “A Quiet Revolution: The European Court and its Interlocutors”, 26 *Comparative Political Studies*, pp. 50-534.

⁶⁷ See “The EC Court of Justice and the Institutional Reform of the European Union”, text available at www.curia.eu.int/en/instit/txtdocfr/autrestxts/rod.pdf.

Total average -- 3.9 7 15.4

Source: Alec Stone Sweet and Thomas Brunell (1998)

The reason why the number of requests for preliminary rulings raised over time are multiple.⁶⁸ To begin with, both the legal profession and the EU business community and citizens learned in time to avail themselves of EC rules and the individual rights thereby derived in legal disputes brought before the national courts. In their turn, national courts became more familiar with the relationship between EC and national law. Second, the preliminary reference procedures are easily accessible, as they involve *no cost*. Third, the preliminary reference mechanism is an opportunity for the national courts to increase their institutional influence on the national arena: in short, the possibility to reply on an ECJ ruling that has binding effects on national institutions and higher courts that will deal with the same case on appeal offers them the opportunity to express their position on important policy issues, thus increasing their institutional weight. In other words, *the preliminary reference procedure is, in a certain sense, an additional guarantee of judicial independence in the Member States*.

Table 1.13 shows the distribution of preliminary reference procedures as number and subject over the period 1961-1995. A good share of the procedures are related to agriculture and freedom of movement for goods (internal market). Also, the share of procedures related to the approximation of laws seems to be on the rise, whereas the percentage of procedures related to agriculture, social security, taxation and freedom of movement of workers seems to be decreasing.

TABLE 1.13 Distribution of preliminary references by subject, percentage and number

<i>Subject</i>		<u>1961-70</u>	<u>1971-75</u>	<u>1976-80</u>	<u>1981-85</u>	<u>1986-90</u>	<u>1991-95</u>
Agriculture	%	20.4	30.9	25.1	20.3	19.6	12.5
	n	(30)	(109)	(176)	(153)	(160)	(135)
Free movement of goods		13.6	19.6	17.1	19.8	18.5	14.9
		(20)	(69)	(120)	(149)	(151)	(161)
Social security		19.7	12.5	10.3	8.4	9.1	10
		(29)	(44)	(72)	(63)	(74)	(108)
Taxation		11.6	2	4.6	4.8	8	8.5
		(17)	(7)	(32)	(36)	(65)	(92)
Competition		8.8	6.3	3.6	4.5	5	8.2
		(13)	(22)	(25)	(34)	(41)	(89)

⁶⁸ See George Tridimas and Takis Tridimas (2004), op. cit..

Approximation of laws		2.8 (4)	.3 (1)	1.9 (13)	4.9 (37)	3.8 (31)	5.1 (55)
Transport		2 (3)	.6 (2)	1.4 (10)	1.3 (10)	1.5 (12)	2.9 (31)
Freedom of establishment for companies	.7 (1)	2.6 (9)	2.3 (16)	2.7 (20)	5.6 (46)	6.6 (72)	
Social policy	.7 (1)	.3 (1)	1.1 (8)	3.7 (28)	4.2 (34)	8.8 (95)	
External relations	.7 (1)	2.8 (10)	1.7 (11)	2.4 (18)	.9 (7)	1.5 (16)	
Free movement of workers	.7 (1)	4.3 (15)	2 (14)	4.1 (31)	5 (41)	3.2 (35)	
Environment	0	0 ?	.4 (3)	1.6 (12)	.9 (7)	2 (22)	
Trade and dumping	0	.6 (2)	1.4 (10)	.9 (7)	.9 (7)	1.8 (19)	
Total	147	352	702	754	816	1084	
% of the total no. of procedures initiated over the period	3.8	9.1	18.2	19.6	21.2	28.1	

Source: Alec Stone Sweet and Thomas Brunell (1998)

At the time of writing (November 2005) the ECJ had on its role only 2 preliminary reference procedures originating from the new Member States – one initiated by a Polish court, and the other by a Hungarian court. As to direct actions involving the new member States, at the same date the situation was as follows:

- 2 direct actions initiated by Poland against the European Council (on transition periods in agriculture);
- 12 actions initiated by a Czech company (beer producer) to annul decisions of the European Office for the Harmonization of the Internal Market (OHIM) related to intellectual property law ;

- 1 action initiated by a Slovak steel company against the Commission, regarding the allocation of greenhouse emission quotas;
- 1 action initiated by the Commission against Estonia for failure to transpose an EC directive;
- 1 action initiated by Estonia against the Commission, requesting the annulment of an EC regulation in the field of agriculture; and
- 1 action introduced by an Estonian citizen against the Council, related to fisheries.

The reduced number of requests for preliminary rulings coming from the courts of the new Member States should not be considered surprising: on the one hand, as mentioned above, older member States, such as Ireland, Spain, Greece and Portugal, had a similar experience in the period following accession. On the other hand, some of the older Member States, such as Portugal, Greece, Ireland, Denmark and Luxembourg, traditionally generate a low number of preliminary reference procedures.

2. Cooperation between the national courts and the European Commission

Article 5 EC establishes the duty of the Member States and EU institutions to cooperate in a loyal and constant manner for attaining the objectives of the Treaty. Based on this principle, the European Commission has the duty to cooperate with the courts of the Member States, which in their turn have the duty to ensure compliance with and the application of EC law within the internal legal system. In what follows we briefly present the cooperation relationship between the Commission and national courts in the application of EC competition rules and the control of state aid. Competition is an area of the *acquis* raising particular issues from this perspective, for the following reasons: in the application of EC competition and state aid rules national courts are confronted with complex and very technical issues; the Commission has special attributions in this area, combining the role of „policeman”, prosecutor and judge, and its cooperation with the national courts is, likewise to the preliminary reference procedure, a modality to ensure the uniform application of EC law at the level of the Member States. In practice, however, the relationship of cooperation between the Commission and national courts in this domain of EC law has never been sufficiently clear or without problems.

The pre-modernization period. Before the recent adoption of the program for the modernization and decentralization of EC competition law enforcement (Council Regulation 1/2003⁶⁹) the relationship between the national courts and the Commission in this area of enforcement cannot not be described as real cooperation. In the procedural context of the pre-modernization period (Council Regulation 17/1962) national courts were entitled to apply only Article 81(1) EC – namely, the provision declaring void practices and agreements with an anticompetitive effect on the internal market –whereas the Commission had the exclusive power to grant exemptions from this prohibition based on Article 81(3) EC. This clear-cut division of competencies in the application of Article 81 EC reduced considerably the role of national courts, limiting it in practice to declaring the (partial or total) nullity of anticompetitive agreements, and to awarding damages for losses resulting from anticompetitive agreements and practices, based on national law. Before the *Courage v. Crehan* judgment,⁷⁰ which establishes that actions for damages resulting from infringements of EC competition law can be based directly on the Treaty provisions, such actions were

⁶⁹ Council Regulation No. 1/2003 of 16 December 2002 on the application of Articles 81 and 82 EC, OJ L 1 [2004].

⁷⁰ Case C-453/99, [2001] ECR I-6279.

decided according to national rules.⁷¹ Of course, the latter were to be applied according to the EU *principle of equivalence* (according to which national rules cannot be applied to actions based on Community rights in a less favourable way than to actions based on rights resulting from internal law) and *effectiveness* (according to which national rules cannot obstacle or impede the exercise of Community rights).

The Commission's 1993 *Notice on cooperation between national courts and the Commission in the application of Articles 81 and 82 EC*⁷² offers more details about the cooperation relationship before modernization. In order to establish whether a certain practice or agreement were caught by the interdiction established in Article 81(1) EC, national courts were required, first, to take into account the Commission decisions relevant to the case. Second, national courts could not declare incompatible with Article 81(1) EC agreements or practices that have been or were about to be approved by the Commission by way of exemption, based on Article 81(3) EC. Thus, in practice, national courts needed to verify whether the agreement or practice under examination had not been the subject of a Commission approval decision based on Article 81(3) EC, was not covered by the block exemption regulations adopted by the Commission, and have not been the subject of a so-called "comfort letter" (in the context of the notification and approval procedure set by Regulation 17/62, the Commission introduced these letters as informal acts ensuring the parties that the Commission did not intend to question the legality of their practice or agreement, without having to issue a formal decision in this sense). Third, national courts needed to check whether the agreement or practice in question were notified to the Commission for approval. When the notification obligation had not been respected, the agreements in question could not be approved by the Commission based on Article 81(3) TCE, and therefore could be declared void by national courts under Article 81(1) EC. When the notification obligation had been respected, but the Commission had not yet pronounced a decision, the national courts had the following options:

- to find that, in view of the existent relevant EC case law, it is unlikely that the Commission would grant an exemption based on Article 81(3) EC, and thereby rule the agreement void based on Article 81(1) TC; or
- to find possible that the Commission could grant an exemption based on Article 81(3) EC, and thereby suspend proceedings until the Commission issued its decision, possibly also adopting interim measures, if necessary.

The Commission, in its turn, engaged to support national courts in the application of Article 81 EC in the following ways:

- by providing, upon request from the national courts, procedural information relevant to the case - such as, whether the situation is under the Commission's attention, if a formal investigation has been opened, if a decision has already been adopted, or a comfort letter has been issued, if the notification procedure has been respected, etc.;
- by providing estimates on the period of time needed in order to adopt a formal decision prohibiting or exempting the anticompetitive agreement in question;
- by giving (non-binding) opinions on the interpretation of the EC rules relevant to the case;
- by giving an interim opinion on the possibility that the agreement be approved by way of exception – in cases where the Commission did not foresee as possible the

⁷¹ See, for example, Ingo Brinker: "An Overview of Damage Actions in the EU", *International Business Lawyer*, August 2003.

⁷² OJ C 39 [1993].

adoption of an exemption decision, national courts could rule on the incompatibility of the agreement with Article 81(1) EC; and

- by making available to the national courts statistics, market studies, and relevant economic analysis.

The post-modernization period. Regulation 1/2003, in force since May 2004, brought about two major changes in EC competition law enforcement: 1) the administrative system of prior notification and approval, according to which anticompetitive agreements and practices that did not follow the procedure were considered void under Article 81(1) EC, was eliminated; 2) the Commission's monopoly over granting exemption based on Article 81(3) EC was eliminated, and hereafter this provision can also be applied by national competition authorities (NCAs) and national courts. By decentralizing the application of EC competition rules, the Commission hopes to obtain their more effective application and freeing a considerable part of its own resources, previously engaged in examining notifications, in order to better concentrate on cartels, merger control and abuses of dominant companies.

The modernization program redefines the relationship between national courts, on one hand, and NCAs on the other, and the Commission in the area of EC competition law enforcement. In April 2004 the Commission published 6 Notices completion and entailing aspects of Regulation 1/2003, also known as "the modernization package".⁷³ One of these Notices defines cooperation within the newly-established European Competition Network, which comprises the Commission and the NCAs of the Member States.⁷⁴ Another Notice redefines the cooperation relationship between the Commission and national courts in this domain.⁷⁵ (thus replacing the 1993 Notice mentioned above). The Notice introduces a few significant changes in this relationship, starting from the basis that in the new enforcement system national courts have, at least in principle, equivalent competencies with those of the Commission in relation to the application of Articles 81 and 82 EC. Thus, for the future, the Commission will have:

- the *duty* to provide to the national courts all information at its disposal that is relevant to their cases (mainly procedural information, but also proofs, etc.) within maximum 1 month following their request;
- the duty to give, upon request from the national courts, opinions on the interpretation of EU rules relevant to their cases or the factual situation, within 4 months from receiving the request;
- the power to intervene, on its own initiative and with the approval of the national courts, in proceedings before the national courts, as *amicus curiae* - by presenting orally or in written observations related to the economic interpretation of the circumstances of the case or the interpretation of the relevant EC rules – whenever such intervention is deemed necessary in order to ensure consistency in the application of EC competition rules. Such opinions are not binding on the national courts. (We mention that, also in relation to the objective of preserving consistency in implementation, Article 15(2) of Regulation 1/2003 imposes a duty on the member States to communicate as soon as possible to the Commission the judgments of the national courts based on Articles 81 and 82 EC).

⁷³ The notices in the legislative package are available at : <http://europa.eu.int/comm/competition/publications/publications/#modernisation>.

⁷⁴ OJ C 101 [2004]. For a detailed discussion on the European Competition Network, see, e.g., Claus-Dieter Ehlermann si Isabela Atanasiu, eds. (2004): *European Competition Law Annual 2003 – Creating the EU Network of Competition Authorities*, Hart Publishing, Oxford.

⁷⁵ OJC 101 [2004].

According to Article 16 of Regulation 1/2003 – taking over the principles established by the ECJ in *Delimitis*⁷⁶ and *Masterfoods*⁷⁷ - national courts should not pronounce judgments conflicting with Commission decisions, and will have to also avoid pronouncing judgments that may be in conflict with future Commission decisions – thus being called to suspend proceedings until when the Commission adopts its decision.

The limited role of national courts in the application of Articles 81 and 82 EC. The settings described above may give the impression that national courts have a significant role to play in the application of EC competition rules. In reality, however, both before and after the introduction of the modernization program, the EC antitrust enforcement system has been, and will continue to remain predominantly administrative – in other words, enforcement is principally in the hands of the Commission and NCAs. According to information available on the Commission site reserved to the publication of national judgments in application of Articles 81 and 82 EC,⁷⁸ during the period following modernization and until November 2005, a good part of the older Member States and all new Member States did not report any internal judgment applying EC competition rules. Among the Member States that are more “active” in this sense are Germany (21 judgments over the observed period), France (14 judgments), Spain (10 judgments), Austria (9 judgments), and The Netherlands (8 judgments) – while Italy and Ireland, for example, did not report any judgment during the observed period. By contrast with this situation, the members of the European Competition Network initiated over the period May 2004-October 2005 a total number of 475 new investigations, 97 of which will be concluded with a formal decision.⁷⁹

IT is obvious that, by contrast with the situation in the US, where antitrust rules are implemented mainly through the court system, in the EU the share of judgments in this domain is much more reduced.⁸⁰ The reasons for this contrast are multiple: to begin with, the administrative prior notification and approval system set up by Regulation 17/1962, in which the Commission retained extensive competencies, discouraged both national courts and NCAs from applying Article 81 EC. Second, at least until relatively recently (more specifically, until the *Courage v. Crehan* judgment), the conditions under which national courts could rule on actions in damages related to infringements of Articles 81 and 82 EC were unclear, given the lack of a clear procedural framework in this sense at EU level. It is quite suggestive that, for example, until February 2005 courts in the UK have rules only twice on actions in damage based on Article 81 EC (one of these two cases being *Crehan*).⁸¹ Third, from the standpoint of the parties, administrative enforcement is more advantageous, in so far as procedures are speedier and less costly. Fourth, it was often argued that the European competition law system does not offer sufficient incentives for litigation. For example, most European jurisdictions do not offer punitive damages in the area of competition law, whereas the US antitrust system can rely on the availability of the so-called “treble damages”. This argument is disputed, however, some commentators pointing to the fact that in practice the European jurisdictions offer the possibility of obtaining compensation for damages equally attractive as in the US system.⁸² It may be too soon to evaluate whether the modernization program will succeed to stimulate private enforcement of EC competition rules in Europe. At the end of the year 2005

⁷⁶ Case C-234/89, [1991] ECR I-395.

⁷⁷ Case C-344/98, [2000] ECR I-1214.

⁷⁸ See http://europa.eu.int/comm/competition/antitrust/national_courts/index_en.html.

⁷⁹ See the report available on DG COMP's website, at http://europa.eu.int/comm/competition/antitrust/cases/ecn_1.pdf.

⁸⁰ For a detailed comparative study in this sense, see Clifford A. Jones (1999): *Private Enforcement of Antitrust Law in the EU, UK and US*, Oxford University Press.

⁸¹ See Richard Wainwright (2005): “Application of EC Competition Rules by National Courts”, paper presented at an IBA conference in Brussels, 9-11 March 2005, text available at <http://www.ibanet.org/images/downloads/Richard%20Wainwright%20-%20Paper.pdf>.

⁸² See Clifford A. Jones (1999), op. cit.

the Commission will publish a Green Paper on modalities to facilitate actions in damages based on EC competition rules.⁸³ At any rate, it is reasonable to expect that the state of play in the older Member States in this respect be at least reproduced in the new Member States, although at the moment the available information is not sufficient to confirm this hypothesis.

It is interesting to mention in this context that one of the arguments invoked by those opposing the Commission's modernisation proposal was that national courts in the Member States, and especially in the new Member States, do not have sufficient experience, expertise to apply effectively Article 81 EC – a task that involves extremely complex and technical evaluations.⁸⁴ For instance, only some of the Member States have specialised courts in the area of competition law. Moreover, if UK courts for example can rely on the possibility of appointing independent experts, in the majority of the continental jurisdictions the courts must reply on the arguments, expertise and proofs brought forward by the parties. It is hoped that in the new enforcement system this problem will be at least in part solved through the support offered by the Commission to the national courts, *inter alia* through its interventions as *amicus curiae*. With respect to problems related to the lack of expertise at the level of national courts, since 2002 the Commission co-finances, together with the Member States, a training program for national judges on issues of EC competition law enforcement.⁸⁵ Over the period 2004-2006 the Commission will allocate 550,426 Euro for the financing of this training program.

The role of national courts in the application of EC state aid rules.⁸⁶ In this area of EC competition law enforcement we observe an even more clear-cut separation of competencies between the Commission and national courts. Article 88 EC gives to the Commission exclusive competencies over the control and monitoring of state aid given in the Member States. The latter have the duty to notify to the Commission for approval any plans to introduce – be it at individual level, or through an aid scheme - or modify state aid (the so-called “notification clause”). Furthermore, the Member States are obliged not to apply aid measures notified to the Commission for approval until the latter adopts a decision on their compatibility with Article 87 EC (the so-called “stand-still clause”).

In cases where the Commission does not react to a notification within maximum 2 months, the aid measure can be considered implicitly approved. When, after preliminary examination of the notification, the Commission finds there are reasons for considering the measure incompatible with Article 87 EC, a formal investigation is opened. This investigation may end either with a negative decision of the Commission (i.e. the aid measure is declared incompatible with Article 87 EC), or a positive decision (i.e., the aid is approved on one of the exemption grounds foreseen in Article 87(3) EC, which include economic efficiency considerations, social and economic cohesion objectives, etc.), the latter being sometimes conditional (namely, approval is made conditional on fulfilling certain compensatory conditions, destined to reduce the anticompetitive effects of aid).

⁸³ See Neelie Kroes (2005): “Enhancing Actions for Damages for Breach of Competition Rules in Europe”, speech presented on the 22 September 2005 at the Harvard Club in New York, text available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/05/533&format=HTML&aged=0&language=EN&guiLanguage=en>.

⁸⁴ See, for example, Claus-Dieter Ehlermann and Isabela Atanasiu, eds. (2001): *European Competition law Annual 2000 – The Modernization of EC Antitrust Policy*, Hart Publishing, Oxford.

⁸⁵ See Richard Wainwright (2005), op. cit.

⁸⁶ Observations in this sub-sections are largely based on the results of an independent study carried out in 1999 for DG COMP, entitled *Report on the application of EC state aid rules by national courts*, text available at http://europa.eu.int/comm/competition/state_aid/legislation/app_by_member_states/.

The Commission has the power to request Member States to recover illegal state aid (i.e. aid given in breach of the notification and stand-still obligations), including legal interest accruing for the sum since the date it was paid.

The role of national courts in the application of EC state aid rules is, first of all, to ensure that the Member States comply with the notification and stand-still obligations, second, to ensure recovery of illegal aid, and third, to protect individual rights arising from non-compliance with the notification and stand-still obligations of the Member States. National courts are encouraged in particular to use all instruments available in internal law in order to suspend payment of illegal aid and its recovery.⁸⁷

Thus, in practice, national courts may be called to rule on one of the following aspects:

- to interpret and apply the Community concept of “state aid”, so as to verify whether the Member State in question has indeed breached the notification and stand-still clauses (in this context, national courts can rely on support from the ECJ through the preliminary reference procedure, or from the Commission, which may give opinions on the interpretation of EC state aid rules);
- to adopt, upon request from competitors of the aid beneficiary, interim measures suspending the payment of aid until the Commission adopts a decision on its compatibility with Article 87 EC;
- to rule, based on national rules, on actions in damages introduced by the competitors of the aid beneficiaries;
- to put into effect the Commission’s negative decisions, by ordering recovery of illegal aid;
- to rule on actions introduced by the competitors of the aid beneficiaries which challenge the validity of the administrative act on the basis of which the aid was awarded, or the validity of a Commission decision approving the aid in question.

A relatively recent study concerning the application by the national courts of EC state aid rules⁸⁸ shows that, until 1999, national courts had adopted only a total of 199 judgments in this area – 75% of which originating from courts in Germany and France. For example, 16 of these judgments regard recovery of illegal aid. Other 60 judgments – standing for 52% of the total – were issued following actions introduced by the competitors of beneficiaries of illegal fiscal aid, which argued that the higher taxation level applied to them by comparison with their competitors is an infringement of Article 87 EC. The large majority of such actions were rejected by the national courts. In other 20 cases, rules in administrative proceedings, the competitors of aid beneficiaries contested the validity of administrative acts granting state aid, but only one of such actions was successful. The authors of the study conclude that the low rate of successful private actions in this domain is partly due to the complexity and insufficient transparency of EC state aid law, and partly to the reduced knowledge at the level of national courts of this area of EC law.

3. General observations on the capacity of national courts to apply the *acquis*

As already mentioned in the introduction to this section, the criteria established for the accession of the Central and Eastern European countries to the EU (the so-called “Copenhagen criteria”) did not include precise standards for the evaluation of the capacity of administrative bodies and national courts in the candidate countries to apply the *acquis*

⁸⁷ See Commission Notice on cooperation with the national courts in the application of EC state aid rules, OJ C 156 [1995].

⁸⁸ See above.

effectively. Starting with the publication in 2001 of the *Enlargement Strategy Paper*),⁸⁹ the Commission placed more emphasis on the preparation of national courts in the candidate countries for this complex task.⁹⁰ Thus the Commission elaborated, together with each of the candidate countries, an *Action Plan* starting from Spring 2002, comprising various measures destined to strengthen the administrative and judicial capacity of the candidate countries until the date of accession. In 2002, for example, the total sum allocated for financing such actions was of € 1 billion.

A comparative study performed during the same year on the 10 candidate countries⁹¹ shows that the majority had adopted by that date complex reforms of the organisation of their judiciary, though these reforms had not yet been put in place, or in some cases, the implementation of the reform brought to the surface certain problems that required amendments. Notably, the efforts to reform the judiciary in the candidate countries coincided with similar reforms undertaken in some of the older Member States: countries such as Ireland, Denmark, Belgium and The Netherlands established Supreme Councils of the Magistrates only recently, and Italy was engaged in a profound reform of its judicial system, with controversial outcomes.⁹² The same study underlines that the Commission has been often ambiguous about the reform of the judiciary system in the candidate countries. In the absence of precise criteria for the reform agreed at Community level, reforms in the candidate countries were mainly conceived with support from experts from the older Member States, the outcome being that in some cases the candidate countries automatically “imported” solutions that may have not been the most appropriate for the circumstances of their own jurisdictions.

The comparative study of judicial reforms in the 10 candidate countries identifies two major trends: on the one hand, where reforms involved principally strengthening the autonomy of the courts (Hungary, Lithuania), unwanted side-effects of isolation and corporativism have surfaced in parallel. On the other hand, in countries where the executive branch maintained a considerable influence over the organisation of the judicial system and the recruitment of judges, problems related to the independence of the national courts persist. The study concludes that, at the level of the year 2002, all 10 candidate countries needed to ensure more transparency in the recruitment, promotion and evaluation of judges, and needed to introduce training programmes for the judges that would combine legal issues with those of ethical and professional nature, including management skills.

⁸⁹ European Commission (2001): *Enlargement Strategy Paper*, text available at <http://europa.eu.int/comm/enlargement/report2001/>.

⁹⁰ See the Commission’s annual progress reports on the candidate countries, available on the site mentioned above.

⁹¹ EUMAP, Open Society Institute (2002): *Monitoring the EU Accession Process – Judicial Capacity*, text available at <http://www.eumap.org/topics/judicial/reports/judicial02/>. See also EUMAP, Open Society Institute (2001): *Monitoring the EU Accession Process – Judicial Independence*, text available at <http://www.eumap.org/topics/judicial/reports/judicial01/>.

⁹² See e.g. Giuseppe Di Federico (2002): “Judicial Independence in Italy: A Critical Overview in a (Non-Systematic) Comparative Perspective”, USAID Office of Democracy and Governance technical papers, text available at <http://www.usaid.gov/democracy/pdfs/pnacm007.pdf>, showing that, in the Italian case, the primary pursuit of the independence objective, neglecting aspects such as how to ensure accountability and to guarantee professional competence, proved in the end to be an obstacle on the way to achieving the independence objective in itself.

2 Assessment of the status and trends revealed by the analysis of indicators and conclusions-suggestions with regard to the policies followed by the Member States in the post-accession period

This section presents – by comparative analysis – the main elements of macroeconomic policies management before and after the date of accession, as well as the risk factors marked out at macroeconomic level before and after this moment.

2.1 Macroeconomic policies in NMS-8

The new Member States of the European Union could not adopt the EURO as national currency concurrent with their entry in the EU in May 2004, due to the fact that the regulations of the European Central Bank have been already modified in 2003, introducing new conditions for the integration into the EURO area. Therefore, the NMS-10 will be liable to prove that their economies are convergent to the economies of the states in the EURO area, implying that the macroeconomic outcomes, and especially the budgetary ones, will have met the criteria laid out within the Treaty.⁹³

During the accession negotiations, the Member States did not ask for derogations in this regard and conditional withdrawal possibilities have not been granted to any of the states. Consequently, at the time when the convergence criteria will be fulfilled, the NMS-10 will be liable to adopt the EURO as single currency in circulation in the domestic economy area.

2.1.1 THE ACCESSION TO THE ECONOMIC AND MONETARY UNION AND THE IMPLICATIONS ON THE MACROECONOMIC POLICIES

2.1.1.1 Brief history of the Economic and Monetary Union and of the conditions of accession to the EMU

The Economic and Monetary Union (EMU) was a three stage process. The first stage (1990-1994, for the EU Member States of that period) had as main objective the full liberalisation of financial capital transactions (Art. 56 of the EC Treaty). The second stage (1994-1999) included the implementation of the convergence measures and the achievement of the necessary extent of independence for the central banks of the Member States. An essential condition was to prohibit financing of the budgetary deficit in a manner that should not affect the interests of the European institutions, of other governments in the Member States, either local, regional or central (as a priority, granting of loans to the fully or partially stat-owned companies was prohibited). The third stage has begun on January 1, 1999, and automatically implied that at the moment of their accession to the EU, on May 1, 2004, the New Member States entered directly this stage of the EMU. These states have the status of “Member States with a derogation” - as referred to in Article 122 of the EC Treaty. This status entitles them to certain exceptions (Art. 122 (3)):

- The European Council may not enforce financial penalties or penalties of other nature if the Member State persistently defaults the conditions for participation to the EMU according to the institutionalized procedures;
- There are certain measures of monetary policy that may be applied outside the clearly defined and conditioned EMU framework;

⁹³ - Significant changes, see Decision no 2003/223/EC, and COM(2004) 748 final.

- The Member State does not bare certain rights and obligations related to the European System of Central Banks (ESCB) as defined in its statute (Art. 43 ESCB).

Concomitantly, the Member States with derogation have no voting right in the Council for the decisions on the EMU laid out in Art 122(3). Despite all this, articles 119 and 120 with reference to the Member States problems in the management of the foreign payments balance apply even to the case of the Member States with derogation.

For being able to monitor the budgetary discipline necessary for the accession to the EMU, the new Member States will be the subject to a periodical supervising procedure based on reports on the progress of the process leading to the adoption of the EURO, which shall prevalently analyse price stability and the health of public finance within the respective economies. The NMS-10 have initiated and will initiate, up to the integration in the EURO area, multi-annual stability and convergence programmes and, every second year or at the request of an EU Member State, the European Commission and the European Central Bank will issue a report on the convergence to the EURO area, according to the guidelines set out in the following criteria:

- Price stability, measuring inflation as against the equivalent indicators in the three EU Member States with the lowest level of inflation;
- Long term interest rates, as against the equivalent rates in the same three EU Member States with low inflation levels;
- Budgetary deficit below the limit of 3% of GDP concurrent with keeping the public debt below the level of 60% of GDP;
- Stability of the actual exchange rate of the national currency, proved over a period of 2 years before the effective moment of accession to the EURO area;
- Verification of the legislative compliance in banking, particularly the aspect of the national legislation being in accordance with articles 108 and 109 of the EC Treaty and the ESCB statute.
- Presence of serious derails in the major macroeconomic policies and the global macroeconomic evolution.

The effective adoption of the EURO by a Member State with derogation or another Member State which is not yet a member of the monetary area is a decision adopted on a majority bases at the Council level, based on the convergence reports. Once the decision adopted, the Council will establish the definitive exchange rate between the EURO and the former national currency. There is a set of technical measures to be implemented before this moment, related to the presentation of the currency in the national-society space and the existence of the necessary infrastructure. In the period of two years preceding the effective accession, the Euro currency will be compulsory used in inter-banking transactions.

Due to the increase of the number of the EURO area members, the European Central Bank proposed a rotation system meant to maintain the efficiency in the management of the European monetary policy, Protocol appended to the Treaty of Nice (Decision 2003/223/EC)

THE ECB ROTATION SYSTEM

The role of the six members of the Executive Board (EB) is to represent every Member State of the EURO area; they are appointed in accordance with a procedure clearly laid out within the Treaty (Art. 112(2)) and have permanent voting rights in the Governing Council (GC). The President has a decisive vote in case of tie vote in the Governing Council. Five fundamental principles of rotation have been imposed:

- a) Each member of the EB has a voting right of equal importance. According to the proposed new system, access to the EB is given by rotation, so this principle will be solely applied at the top level of the selection.
- b) Participation *ad personam*. Each member of the GC will attend every meeting, regardless the voting right at that moment.
- c) Representativeness. Taking into account the differences between the Member States in terms of financial power and consumer market, the rotation system proposes that the “large” states shall be more often represented in the EB (a more frequent rotation) than the other states.
- d) Automaticity/Robustness. The rotation system has to be designed in such a manner which allows it to adjust automatically to the process of euro-area enlargement and to ensure the same rights and obligations to any potential new member state as they are for older members. The system has to accommodate at least 27 Member States (i.e. the 12 current members of the euro area, the three pre-ins – Denmark, UK and Sweden – the ten new Member States plus the two acceding countries, Romania and Bulgaria).
- e) Transparency. The rotation system shall be built up in a transparent manner and shall meet the demands of the Community law.

Dependent upon the envisaged moment of the EURO area enlargement, two stages have been designated for the reform of the rotation system: the first one for the case when the number of governors exceeds 15 and the second one for the case when the number of governors will exceed 22.

The system proposes an allocation of the number of CG members on groups with different rotation frequency and representation, according to the following two criteria:

- The share of each Member State in the aggregate GDP - at market price – of the EURO area; the decision weight assigned to this criterion is 5/6.
- The share of each Member State in the aggregate monetary balance (consolidated at the EURO area level) of the monetary financial institutions in the EURO area; the decision weight of this criterion is 1/6.

Stage I

From the date on which the number of governors in the EURO area exceeds 15 and until it reaches 22, the governors will be allocated to two groups. A first group shall be composed of 5 governors representing the states with the highest share according to the above mentioned two criteria, aggregated (in the present-day situation, if Great Britain will stay outside the EURO area longer than Poland, the five states represented in the priority group will be: Germany, France, Italy, Spain and Poland, according to the prognosis indicating that Poland's GDP will outbalance in 2010 the GDP of Holland, even in current prices).

The five governors in the first group shall share in rotation four voting rights and the others in the second group shall be assigned 11 voting rights. The system will be flexible so that it will ensure an at least equal rotation frequency for the first group, regardless the number of members in the second group.

Stage II

In this stage, the governors will be allocated to three groups: the first group stays similar to the one in the first stage, the second group shall be always composed of half of the total number of governors in the EURO area, according to a ranking of the size of the shares established by the two criteria, and the third group shall be composed of the remaining governors. Four voting rights will be assigned for the first group, eight for the second one and three for the latter. When the number of members of the EURO area will reach 27, the

rotation frequencies will be: 80% in the first group, 57% in the second one, and 38% in the third group. Within each group, the members shall have their voting rights for equal amounts of time. The composition of each group shall be revised at the enlargement of the EURO area or at every five years (a re-assessment of the size of shares according to the two principles is proposed for those moments).

Changes in the implementation mechanism of the rotation systems shall be permitted if the votes cast in favour represent at least 2/3 of the total number of GC members (not just the members having a voting right).

The entry into force of the proposed rotation system was recommended for adoption to every member and shall be subject to ratification by each Member State, in accordance with the constitutional procedures of the respective states.

2.1.1.2 Conditions imposed on NMS-10 before the adoption of the euro

The role of the exchange rate mechanism (ERM II) in the accession to the EURO area process is considered to be crucial, the participation of a member state in this process being perceived as the antechamber of the integration in the area. The advantages consist in the assurance of stability by enforcing the monetary and fiscal discipline and the edification of a macro – and – microeconomic climate propitious for sustainable development through the implementation of the proper structural reforms. Equally, the political credibility of the EU Member or Candidate State that enters the ERM II is potentiated by this participation. The mechanism is flexible enough to allow the necessary adjustments and the interventions in the re-alignment of the exchange rate intended for the stabilisation of the shocks generated by the Balassa-Samuelson effect in the convergence period.

The longer period of participation in ERM II before accession – which was three years in the case of EU-11 Member States and was imposed as minimum two years in the case of NMS-10 – ensures the possibility to avoid errors in fixing the irrevocable exchange rate between the national currencies and the EURO.

In this period, expectations of the economic agents are being formed, with regard to the behaviour of the markets in the economies that will access to the Euro area, including the ones related to the very moment of exposure to the Single European Market, which helps in positioning each economic agent in the potential landscape of the economies and in taking medium and long term decisions (investments, expansion plans, labour force policy, etc).

The disadvantages that may more often arise are the ones correlative to the inflationary effects of the potential exchange rate re-alignments, and the efforts of the participant states and the central banks, as well, shall be concerted to prevalently ensure the price stability objective.

2.1.1.2.1 Plans for adopting the EURO in NMS-10 after 2007

In order to be able to adopt the EURO as national currency, the New Member States shall be monitored with regard to the margins of fluctuation of the exchange rate against the EURO for a period of minimum 2 years beginning with the formal participation in the ERM II. Three of the NMS-10 Member States (Slovenia, Lithuania and Estonia) entered the ERM II on June 28, 2004, and expressed their desire to adopt the EURO as soon as possible. On May 2, 2005, other three states (Latvia, Cyprus and Malta) did also enter the ERM II. These data signify that the first three mentioned NMS will not be able to effectively adopt the EURO before 2007, and the other three beginning with 2008, taking into account the period following the decision of adoption, necessary for the implementation of the technical measures involved.

The minimum period of participation in ERM II was reduced from three years (as it took for the first Member States that adopted the EURO) to two years, because, in the case of the New

Member States, it was considered that these were already acquainted with this currency and could use the example of the old Member States for getting prepared for eventual technical, monetary or economic difficulties.

Within the Communication issued with regard to this process, the European Commission noticed that the first wave of adoption of the EURO was a success, although the whole mechanism may be enhanced. An essential element is to ensure in good time a favourable perception of the whole society in relation to the Euro, such as to reduce as much as possible the dimension of potential complications due to a double circulation, and to shorten as much as possible the period of double circulation.

The Commission also points out that the national authorities shall impose measures meant to avoid the potential inflationary effect that did come to the fore in the past, in some cases at the traders' level. Such measures may include: targeted support and incentives for the activity of the consumer association, the compulsory and clear mentioning of the price conversion (old and new currency) in the case of merchandise and services sold to the public, etc.

Anyway, the next moments of integration in the EURO area are not forecasted to have the same impact as the emergence of the EURO area at the beginning of the millennium. So that some NMS will even witness a concomitant "shock" process, meaning that the integration in the EURO area will coincide with the moment of effective admission of the EURO currency on the national markets.

2.1.2 THE MONETARY, FISCAL AND BUDGETARY POLICIES IN NMS-10 BEFORE AND AFTER THE ACCESSION TO THE EU

2.1.2.1 Monetary policies

The positive evolutions on the financial-monetary side in the New Member States of the EU are strongly influenced by the manner of defining the institutional framework necessary for the monetary integration in ERM II of these states, as shown in the previous subsections. Two principles underlie the edification process of this institutional framework:

- a) The strategy of each state in choosing the set of monetary policies and exchange rate is specific, a unique recipe or previously imposed guidelines being non-existent.
- b) A non-discriminating treatment is to be ensured for every state before and during the integration process. The assessment of the measures chosen by each state in the implementation of the institutional framework will use a comparative approach, but will also take into account the pre-set specific conditions.

Before the integration in the EU, the monetary conditions in the New Member States featured some common signs. Except for Slovenia and Slovakia, each of the other eight states crossed an inflationary period, fed mainly by unique-shock type perturbations, generated by adjustments of controlled prices and changes in the indirect taxation system.

Other factors, specific to each country, also existed, like the dramatic increase of wages in the public sector in the Baltic countries, or the depreciation of the Polish zloty due to the slackness of foreign investments.

In 2005, the inflationary trend was stopped in most of the NMS-10 (excepting, eventually, the Baltic countries) as a result of the consistent gains at the level of productivity and exchange rate stability. The monetary policies followed the de-inflationary outcomes and the conditions have been gradually relaxed, leading to the decrease of the interest rates (a process that was extremely manifest also in Romania) in the states that were to enter (Cyprus, Malta, Latvia) or will enter the ERM II, and to their conservation in the other states that already entered this mechanism (Slovenia, Estonia and Lithuania).

In the period before entering the ERM II, the monetary and exchange rate policies continue to be the (full) responsibility of the central banks in the respective states. For all that, one may not talk about a total independence, because the rules of the game will have already been changed at the moment when the respective country accepted the alignment to the obligations laid out in the Treaty of Accession to the EU. Before the accession, many states adopted policies aiming at inflation (as the case of Romania will be starting with 2006) or already adopted community laws replacing the old domestic legislation in the monetary-fiscal domain. After accession, the rate of inflation and the exchange rate are part of the set of policies of community interest, and it is not possible to imagine many independent measures of global-European policy in this domain.

The existence of the independent choice in setting the monetary policy is proved by distinct groups of states that adopted differently principled policies: the Czech Republic, Hungary, Poland and Slovakia have chosen alternatives aiming at inflation; instead, Cyprus, Latvia or Malta are following a strategy aiming at the exchange rate. The reasons of the choice are dependent on the conditions of the economies in the respective states (mainly, the status of public debts and balances of payments), but one can notice that, generally, the larger states (in terms of economic power and domestic markets) trended towards the proceeding of setting the inflation rate at low levels.

Some key aspects have been identified – even under the conditions of heterogeneous sets of monetary policies in NMS-10 – that may represent measures of good conduct at monetary-financial level, that shall ensure a beneficial transaction towards the EURO area and, implicitly, towards the increase of the financial-banking system stability. All these measures are organically related to the necessity of ensuring the credibility of the monetary policy, the one that facilitates the annihilation of the inflationary expectations of the socio-economic system and minimizes the costs of de-inflation related to the labour force market and the national production. How could the credibility of the monetary policy be ensured?

- The monetary policy has to maintain, as an absolute priority, the stability of the price system;
- The constitutional and political framework must clearly point out the independence of the central bank and the political system shall not influence the monetary decisions of the central bank;
- The decisions in the domain of monetary policy, but also the global medium-and-long term strategy, must be transparent and must be often and unequivocally communicated to the society, using a communication language adjusted to the various levels of understanding.

2.1.2.2 Is the fiscal consolidation in danger after the integration?

The fiscal deficits seem to be the main macroeconomic problem displayed by the NMS-10 after the integration moment (excepting eventually Estonia, which had an excess of the consolidated budget in 2004). After the experience of some bad periods – in the years preceding 2004 – when the consolidated budgetary deficits increased, sometimes explosively (the case of Hungary and the Czech Republic), many of the NMS – mainly the states with large economies – adopted special fiscal consolidation and stabilisation programmes beginning with the year of integration.

The factors that generated the fiscal derails before integration were in many cases adjustment shocks like: pre-election pressures, defrayment of debts in the banking system or changes of the accounting system (the switch to the European standards of ESA95 type). After integration, the four NMS having the highest gross domestic product (Poland, Czech Republic, Hungary and Slovenia) set themselves the following fiscal targets:

TABLE 2.1. Consolidated governmental deficits forecasted within the convergence programmes (% of GDP)

Member State \ Reference year	2004	2005	2006	2007
Czech Republic	5.2	4.7	3.8	3.3
Poland	5.4	3.9	3.2	2.2
Slovakia	3.8	3.8	3.9	3.0
Hungary	5.3	4.7	3.6	3.1

In fact, in 2004 the deficits were higher in of Hungary (5.4%) and Slovakia (3.9%) and lower in Poland (3.9%) and the Czech Republic (3.0%). The economic growth at a quick pace will help to attain these targets in the following years, but there is an impressive set of risks marked out by the economic-financial analysts, which seem to have already begun to act in a negative manner:

- The diminution of the economic growth rate;
- The continuance of the fiscal reforms shifting from the direct taxation (wages, profit) towards indirect taxation (VAT, excise);
- The existence of some hidden budgetary funds not fully integrated yet in the consolidated budget, that will be transferred as a result of the increased budget transparency;
- The domestic budgetary co-financing associated with the structural funds coming from the EU;
- The conclusion of the privatisation process without the possibility of bringing additional financing sources to the budget;
- The reform of the pension system, taking into consideration the accelerated ageing of the population in this states, will bring additional budgetary pressures of large extent;
- The political instability generated by elections planned to come off in these years against the increase of the population's dissatisfaction caused by the slackness of the standard of living.

By way of consequence, the expectations of the European analysts for year 2005 progressed towards the deterioration of the consolidated fiscal balances in the case of the NMS that are to implement fiscal and budgetary reforms implying certain risks among those previously mentioned, doubly so as it was ascertained a deceleration in the increase at the domestic demand level (the abatement of the fiscal incomes from indirect taxes), a discretionary increase of expanses in the pre-election periods and related with the co-financing of European funds and a groundless increase of the wages in the public sector. Table 2.2 shows the figures associated to the budgetary deficits of the EU New Member States, against the average values in the EU and the deficits of the Candidate States, for the 2000 – 20005 period (for the current year, the prognosis was issued by the Commission in November 2005).

TABLE 2.2. The new Member States: Budgetary Deficit

New members	2000	2001	2002	2003	2004	2005
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New members	2000	2001	2002	2003	2004	2005
Cyprus	-2.4	-2.4	-4.6	-6.3	-4.6	-4.1
Estonia	-0.3	0.3	1.8	2.6	0.7	0.0
Hungary	-3.0	-4.4	-9.3	-5.9	-4.9	-4.3
Latvia	-2.7	-1.6	-2.7	-1.8	-2.2	-2.0
Lithuania	-2.6	-2.1	-1.4	-1.7	-2.8	-2.6
Malta	-6.5	-6.4	-5.7	-9.7	-5.9	-4.5
Poland	-1.8	-3.5	-3.6	-4.1	-6.0	-4.5
Czech Republic	-4.5	-6.4	-6.4	-12.9	-5.9	-5.1
Slovakia	-12.3	-6.0	-5.7	-3.6	-4.1	-3.9
Slovenia	-3.0	-2.7	-1.9	-1.8	-1.7	-1.8
New members	-3.2	-4.1	-4.9	-5.7	-5.0	-4.2
EU15	1.0	-1.0	-2.0	-2.6	-2.6	-2.4
EU25	0.9	-1.1	-2.1	-2.7	-2.7	-2.5
Euro zone	0.1	-1.6	-2.3	-2.7	-2.7	-2.6

* The figures for 2005 represent DG ECFIN forecast.

Source: Eurostat, 2005.

Applicant countries: budget deficit

Applicant countries	2000	2001	2002	2003	2004	2005
Bulgaria	-0.5	0.2	-0.8	-0.1	-0.7	-1.0
Romania	-4.4	-3.5	-2.0	-2.0	-3.0	-3.0
Turkey	-6.1	-29.8	-12.6	-8.8	-7.1	-6.0

Source: Eurostat, 2005.

A review of the budgetary deficit targets for the following two years is expected, directed to their diminution by 0.5-1.5% of GDP for being able to cope with these trends and to stay within the limits requested by the convergence towards the EURO area programme. In spite of all this, the annually budgetary deficits will be probably higher than the announced ones, which will give rise, in many cases (as it was already announced for the Czech Republic), to the postponement, for the period following year 2010, of the forecasted moment of adoption of the Euro currency. Due to the quick pace of economic growth, the weight of the public debt in GDP still has chances to stagnate or even to diminish in most of the NMS. Table 2.3 presents these aspects in detail, for both the NMS case and the case of the Candidate States, against the average public debt in EU-15, the EURO area and EU-25.

TABLE 2.3. The New Member States: Government public debt

New members	2000	2001	2002	2003	2004	2005
Cyprus	61.7	64.4	67.1	72.2	74.6	76.9
Estonia	5.0	4.7	5.7	5.8	5.4	5.3
Hungary	55.4	53.5	57.1	59.0	58.7	58.0
Latvia	13.9	16.2	15.5	15.6	16.0	16.1
Lithuania	24.3	23.4	22.8	21.9	22.8	23.2
Malta	57.1	61.8	61.7	72.0	73.9	75.9
Poland	36.6	36.7	41.2	45.4	49.1	50.3
Czech Republic	18.2	25.2	28.9	37.6	40.6	42.4
Slovakia	49.9	48.7	43.3	42.8	45.1	46.1
Slovenia	26.7	26.9	27.8	27.1	28.3	28.2
New members	36.4	38.5	39.4	42.2	44.4	45.2
EU15	64.0	63.2	62.5	64.0	64.2	64.2
EU25	62.9	62.1	61.5	63.1	63.4	63.4
Euro zone	70.4	69.4	69.2	70.4	70.9	70.9

* The figures for 2005 represent DG ECFIN forecast.

Source: Eurostat, 2005.

Applicant countries: Government Public debt

Applicant countries	2000	2001	2002	2003	2004	2005
Bulgaria	73.6	66.2	53.2	46.2	44.4	43.2
Romania	23.9	23.2	23.3	21.8	23.5	23.5
Turkey	57.4	105.2	94.3	87.4	83.4	77.5

Source: Eurostat, 2005.

Most of the NMS will diminish the relative public debt, especially due to the consistent increase of the gross domestic product, except for the largest of these states – Poland, whose share in the total amount influences the global performance of the entire group - , Lithuania and Malta, according to the estimations presented in the table. An important conclusion is that, as a result of stopping the pronounced budgetary deficits registered at the beginning of the millennium in these countries, by strengthening the financial discipline imposed within the convergence to the EURO area process, the condition to maintain the public debt below the threshold of 60% seems to be accessible for all NMS. An exception could be offered by the smallest two economies in the group, Cyprus and Malta, which will have to make additional efforts in the next years for not getting in the position to postpone the moment of entry in the EURO area.

2.1.3 THE POLICY IN THE STATE AID AREA

The EU regulations with regard to state aid control form a central element of the *Acquis communautaire*, complementing the policies in the competition area (the anti-trust legislation and the control of fusions between companies). The main objective of the EU in this area is to prevent the governments of the Member States to protect or to promote the national/local companies in the detriment of other competitor companies from the community space. The expression “state aid” defines “any form of assistance offered by the governmental bodies to certain economic agents or groups of companies in a sector”.

Although the EC Treaty does not explicitly define the state aid, it clearly stipulates that the state aid is incompatible with the functioning of the (single European) domestic market. The state aid may consist in grants or state subsidies, fiscal or monetary exemptions and adjournments (debts and interests unpaid in due time, for example), state guaranties or preferential provision of goods or services granted to certain companies. The state aid is prohibited in case it affects trade and distorts free competition (free market). The Treaty specifies – although - the allowable exceptions that are severely controlled in accordance with the EU domestic legislation: the respective exceptions include assistance for regional development, subsidies granted to the “sensitive” sectors and certain “horizontal” support measures (in “horizontal” domains like innovation or environment protection).

The beginning of the transition period took by surprise the economies of the former communist countries, out of which eight New Member States of the EU, characterised by the existence of some important industrial sectors functioning on the bases of massive subsidies from the respective state. In the negotiations with the Candidate States, the EU started from the principle of equal opportunities between the local private companies, the potential foreign investors in these economies and the large companies (previously in the state property) and, thereupon, tried to eliminate any interference of the state in this domain. All agreements

signed before accession provided for full alignment of these New Member States with the EU norms and legislation regarding the state aid area.

An important problem was and still is the disjunction between the pre-existent state aid and the newly granted assistance in a certain domain. The “inherited” aid is permitted, but the Commission had and has the liberty to suggest appropriate measures with a view to future amendments. An example in this respect for the New Member States is offered by the ferrous products industry (mainly the steel industry).

The European Commission suggested, during the pre-accession negotiations with the NMS, that each state shall set up a national (central) authority for the surveillance of the state aids. The measure was implemented quite difficultly by the respective states. The negotiations in the competition policy area (which includes the policies in the state aid area) have been concluded in 2001 with 4 out of the 10 NMS without any request for exemption or adjournment (the Baltic Countries and Slovenia), while with the other six states they have faced delays and difficult talks, which ended up in transitional arrangements, waivers and on-going open sub-chapters. The areas where most difficulties were concentrated are fiscal credits aimed at attracting foreign investors and the restructuring of the steel industry (in the Czech Republic the transition towards a free functioning steel market was long and didn't yet conclude, in the meantime the subsidies putting pressure on the consolidated budget deficit).

The case of the steel industry⁹⁴ is interesting for two reasons: on the one hand, this industry was one of the pillars that based the formation of the European Common Market; on the other hand, the sector has an important share in many of the NMS and Candidate States, the steel production capacity being estimated to around 30 million tonnes per year, in detracton from the 50 million at the beginning of the '90.

Along with the expiry, in 2002, of the European Community of Carbon and Steel Treaty, steel was no longer registered in the new EC Treaty as a sector of European strategic interest and, consequently, the EU legislation with regard to state aids became mandatory for the companies in this sector as well. Despite all this, given the big problems related to the labour forced associated to the sector and the inertness in reorganization and privatisation registered in many Candidate Countries (at the 2002 moment), special conditions were negotiated with the NMS (Poland, Czech Republic, Slovakia) and the Candidate Countries (mainly Romania and Bulgaria), which permitted the extension of the state aids granting period for this sector accounted as sensible. The subsidies were consistent enough, varying, for Poland, the Czech Republic and Romania, between 0,5 and 1,3 billion EURO on the entire granting period. The process was attentively monitored by the EU, such as to ensure the necessary conditions for directing the aid exclusively towards the reorganisation with minimum costs of certain companies. As a result of this supervision process, the European Commission launched two special control procedures (*in-depth probe*), one in Poland (the case of the Huta Czystałowa SA manufacturer) and another one in the Czech Republic (Trinecke Zelezarny a.s.), where the granting of state aids in 2004, in conditions unauthorized by the EU legislation or by the negotiated agreements, lies under suspicion.

Last year, the European Commission (DG Competition) launched a special consultancy programme intended for the definition of a Special Action Plan and a set of clear regulations directed towards the increase of competitiveness in the state aid area.⁹⁵ The document, that is desired to be finalised before 2007 and be turned into a clearly defined legislative set applicable in all the EU Member States, provides for some ex-ante regulations (or norms) in the state aid area:

⁹⁴ - “State aid for restructuring the steel industry in the New Member States”, Max Lienemeyer, DG Competition, EC, spring 2005.

⁹⁵ - “State Aid Action Plan. Less and better targeted state aid: a roadmap for state aid reform 2005-2009”, Consultation Document, DG Competition, EC, Brussels, 2005.

- The state aids may be authorised by the EC to be granted at the notification of the respective Member States, following certain guidelines and in special domains of global EU interest;
- These domains are: regional development that aims at reducing the gaps generated in a discriminated manner; research-development-innovation; environment protection; reorganization or salvation of some companies in difficulty; risk capital.
- Generally, the state aids will be easier accepted if they will aim at the increase of the innovative capacity and the development of the small and medium enterprises sector, or will be intended for the development of human capital (training, job creation etc.)

For authorising the granting of state aids for innovation, the European Commission insists that the respective aid shall be proposed by the government of the state that notifies with a view to correct a market failure. So, the state aid shall be clearly directed towards this failure, which implies:

- to find the optimal instrument of economic policy for the respective type of correction;
- the aid must generate additional innovative activity after implementation and correction;
- the state aid must be proportional in amount to the problem it addresses and its opportunity costs.

When allowing state aid to be used, it has to be taken into account that it would not generate distortions in the trade with products of the given market, and that the market concentration would not be increased as a result of such intervention (aid).

Examples of free market failures that have been identified with regard to the innovative processes, those centred in the permitted policies for granting of state aids (being considered main generators of sustainable development and long run competitiveness) are: innovation as such, as a public good – particularly when linked to issues such as intellectual property or externalities -, the inefficient and non-transparent dissemination of innovation and technological know-how, restrictions and barriers on capital markets (specifically on venture capital), or long-term disequilibrium on labour markets.

The European Commission envisages to finalise by the mid of 2006, following consultations with Member States, the R&D and Innovation Framework and the Risk Capital Guidelines. Also it wants to adopt the general block exemptions by the end of 2006 and the future Environmental Aid Guidelines in 2007.

2.1.4 THE FOREGOING CHALLENGES AND THE TRENDS OBSERVED AFTER THE ACCESSION OF THE NMS-10

In the beginning of 2004, before the moment of effective extension of the EU, many international non-EU organisations, as well as some anti-integration voices within the EU, expressed their scepticism facing the outcome of the forthcoming enlargement process. The arguments were often plausible and well supported by statistical data showing the risks and disadvantages of the already taken political decision. As an example, one of the World Bank's quarterly reports⁹⁶ stated many pessimistic points of views, out of which several addressing expected deceleration of the economic growth rate and potential macroeconomic destabilisation. Other negative expected outcomes were the deterioration of the balance of payments and of the public deficits of the future Member States, as well as the downward shocks to the former economies of the EU-15, particularly hitting their labour markets.

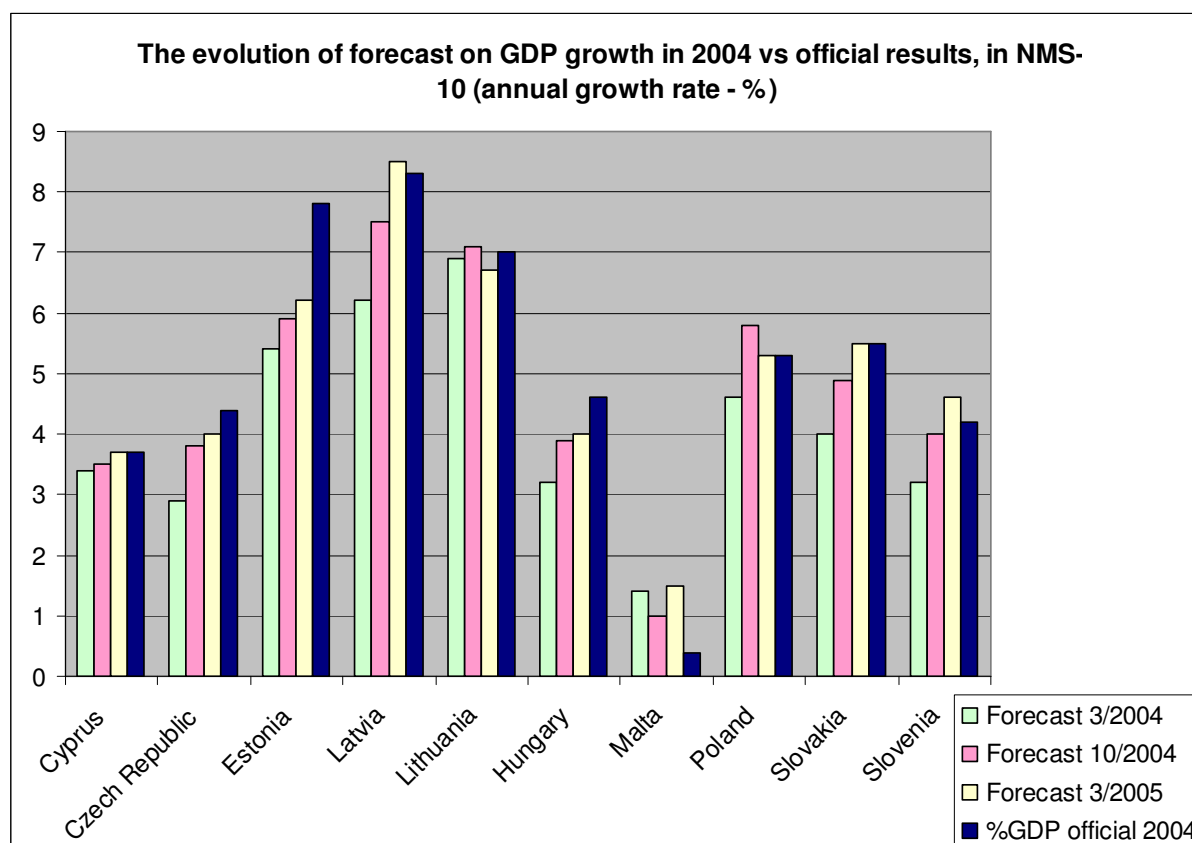
The evolution of the economic growth rate in NMS-10 versus previous expectations

⁹⁶ - EU-8 Quarterly Report of the World Bank, Martin Sasin, Thomas Laursen et al., <http://worldbank.org/ECA/eca.nsf/General>

Despite numerous signs of GDP growth in 2004, many analysts were forecasting that such growth would end up in overheating, as a result of the higher rate of increase in domestic demand than the corresponding growth rates of productivity and the lack of correlation with external balances. The strong increase in the nominal levels of wages together with the continuous appreciation of the national currencies were considered additional inflationary factors, putting pressure in a moment when the FDI inflows seemed to stagnate or even diminish and following the explosion of budget deficits in 2003.

The reality, as shown by the macroeconomic data officially released for the year 2004, contradicted the pessimistic expectations. Consequently, the EU enlargement as of May 2004 didn't produce any negative shock – at least in terms of GDP growth. On the contrary, it has been followed by macro growth results that surpassed all the previous forecasts. Figure 2.1 shows the annual GDP growth rates for each NMS-10 as forecast at every six months starting the beginning of 2004 (the forecasts are based on the CREST model of DG ECFIN, European Commission) and also the effective GDP growth rate as officially reported by Eurostat in 2005:

FIGURE 2.1



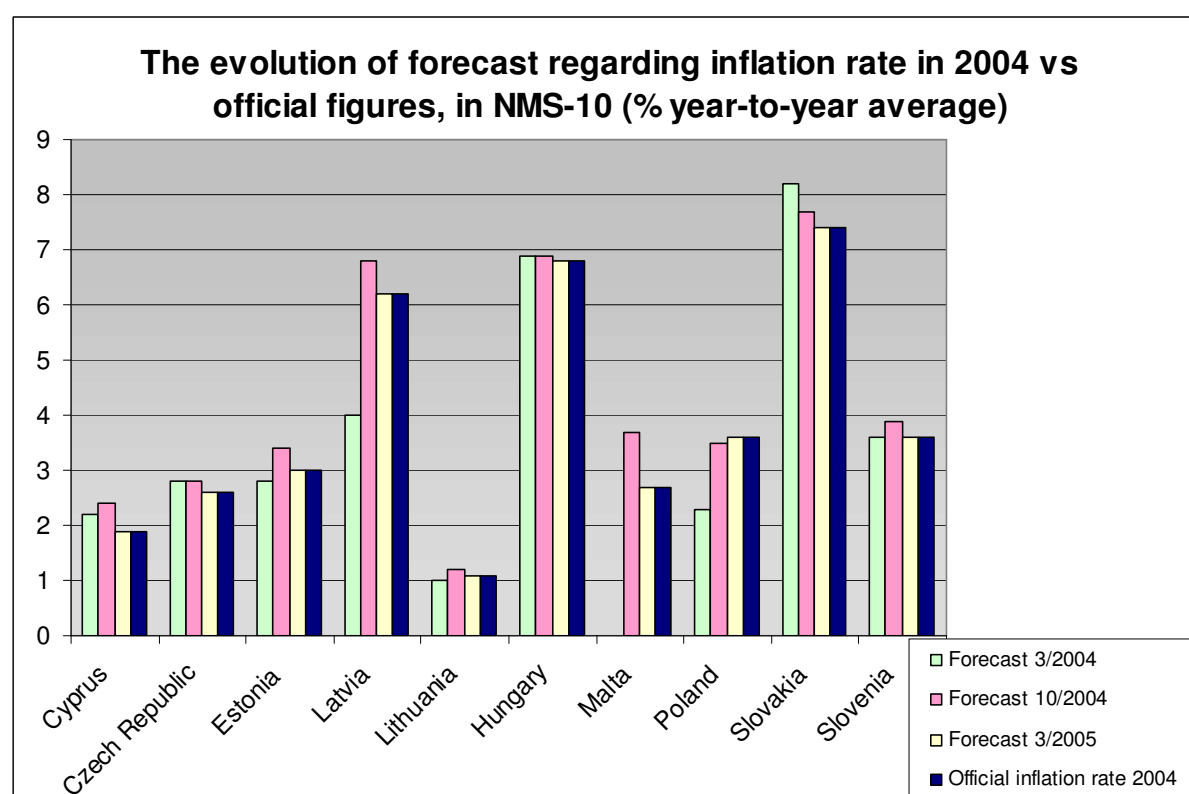
As one can see in the above figure, the forecasts have been revised upward at every six months, once approaching the end of 2004 and reducing the uncertainties facing the real evolution of the GDP components. In the end, with few exceptions, the official results surpassed any of the previous forecasts. The only case in which the forecasts were more optimistic compared to the real achievement was the Maltese economy – the smallest economy of the ten new Member States, having a very small share in the overall GDP of NMS-10. Spectacular upward revisions were made in the cases of Estonia, Latvia, the Czech Republic, Slovakia and Hungary, the differences between forecast and real official GDP growth being higher than 1.5 % in the respective cases.

There is an important message coming out from the above graph: nine out of ten new Member States (except Malta) ended the year 2004 registering GDP growth rates higher with more than 1 % than the average GDP growth rate of EU in 2004, situated at 2.4 %. This means that the process of nominal and real convergence continued after the moment of enlargement, practically unaffected. In 2004, the average GDP growth rate in NMS-10 was 5 %, surpassing its own correspondent in previous year by 1.3 %. For 2005, the estimations (as we are very close to the end of the year, the errors in estimation are minimal) suggest the possibility of repeating a similar performance as the forecast showed once more an ascending trend during this year.⁹⁷ The only economy for which the forecasts were gradually downgraded during 2005 is Poland, probably due to political uncertainties raised by the election year. However, the forecast of the GDP growth in NMS-10 for 2005 is above 4 %, while the same source is estimating half a rate of growth for the overall economy of EU-25.

The evolution of inflation rate in NMS-10 versus the previous expectations

As it was the case with the economic growth, the analysts' expectations (particularly those of DG ECFIN) showed to be pessimistic by the end of 2004, after comparing the real results with the previous forecasts on price indices in NMS-10. As it is presented in Figure 2.2, the inflationary expectations increased after 1st of May 2004. For almost all the NMS-10, except Slovakia, the column corresponding to DG ECFIN forecast as of Autumn 2004 is the highest (signifying the highest inflation rate forecast).

FIGURE 2.2



Nonetheless, with the only noticeable exception of Poland, the effective inflation rate registered during 2004 was below expectations. Even in the case of Poland, the difference between the autumn forecast figure and the officially released inflation rate for 2004 compared to 2003 (see Eurostat) didn't surpass 0.1 %.

⁹⁷ - EC DG ECFIN *EU economy Spring Forecast 2005* and *EU economy Autumn Forecast 2004*, statistical tables.

This finding is not equivalent to a good performance of the NMS-10 states in ensuring or progressing towards price stability. Most of these states have surpassed the hypothetical upper limit as stated within the ERM II mechanisms constraints (the only NMS which registered inflation figures comparable to the euro zone countries was Lithuania). Some of the NMS, such as Latvia, Hungary or Slovakia, crossed a period of high instability, with inflation rates close to the Romanian one (the Romanian economy has been assigned for a long time the status of the counter-performer of the candidate countries group in relation to price stability).

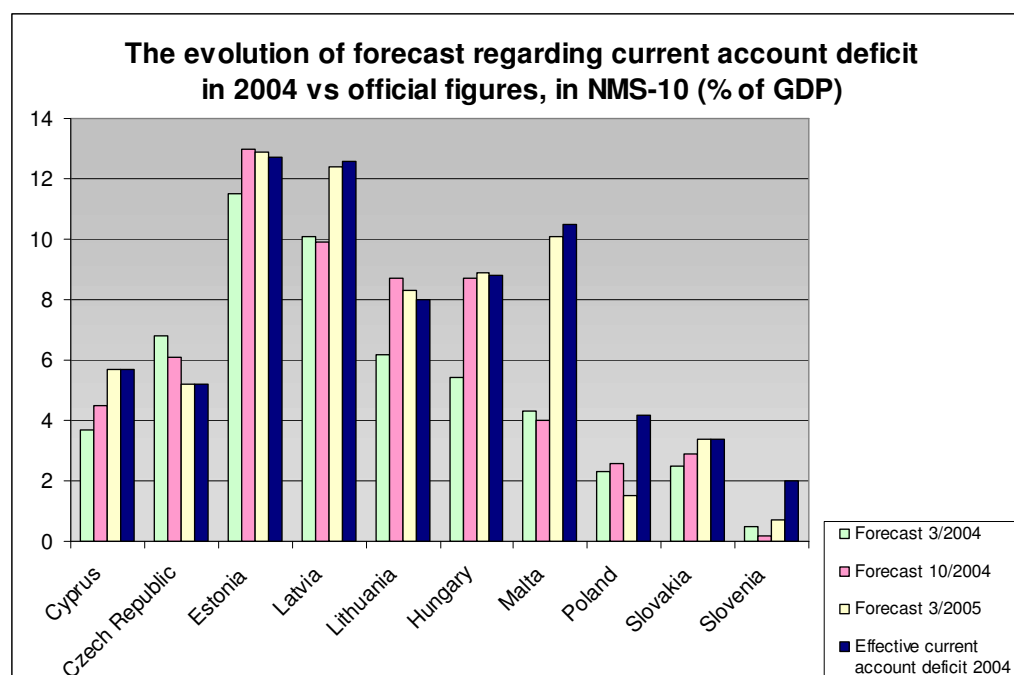
The inflationary pressure remained high in 2005 as well, although the GDP growth rates came down compared to the previous year. The interesting aspect is that, out of the ten NMS, five are estimated to end 2005 with lower inflation than in 2004, while the other half is expected to show inflationary shocks. Even more interesting is that the performers are the first five NMS economies in order of their GDP magnitude, while the Baltic States, Cyprus and Malta had negative results this year.

The evolution of the current account in NMS-10 versus the previous expectations

Due to their high GDP growth rate, the NMS economies saw significant increases in their domestic demand before and immediately after the accession moment, resulting mainly in fuelling imports – as the domestic supply could not adjust suddenly to this demand boost – at a rate higher than the growth rate of exports. Additional factors, such as the appreciation of the national currencies and the increased exposure to the Single Market, pushed in the same direction leading to deterioration of the trade deficit, as well as of the current account deficit. The currencies of the NMS-10 were continuously appreciating against the euro, often in nominal terms, due to positive trends in the productivity and to massive inflows of financial capital; the outcome was that imports became relatively cheaper for domestic consumers.

Almost all NMS saw their trade deficits and their current account positions worsening during 2004, sometimes at a worrying pace. The phenomenon was expected and closely followed by the successive results of the forecasts released during 2004, as it can be seen in Figure 2.3. The only exception was the Czech Republic, country in which exports were the main growth engine in 2004 and in recent years, partly as a consequence of a well-negotiated state aid policy and a supportive structure of foreign investment inflows.

FIGURE 2.3



In the cases of Latvia, Hungary and Malta, the corrections made to forecasts every six months prove the low reaction speed of analysts confronted with this increasing gap between exports and imports, generated mainly by a higher inertia on the export side, thus on the domestic producers side, when exposed to the challenges following the integration moment. Nine out of the ten NMS finished 2004 with current account deficits higher than the expected ones forecast in the beginning of the same year. In the case of Poland and Slovakia, corrections were made even in the estimation run in early 2005, when most of the current account items were already officially known.

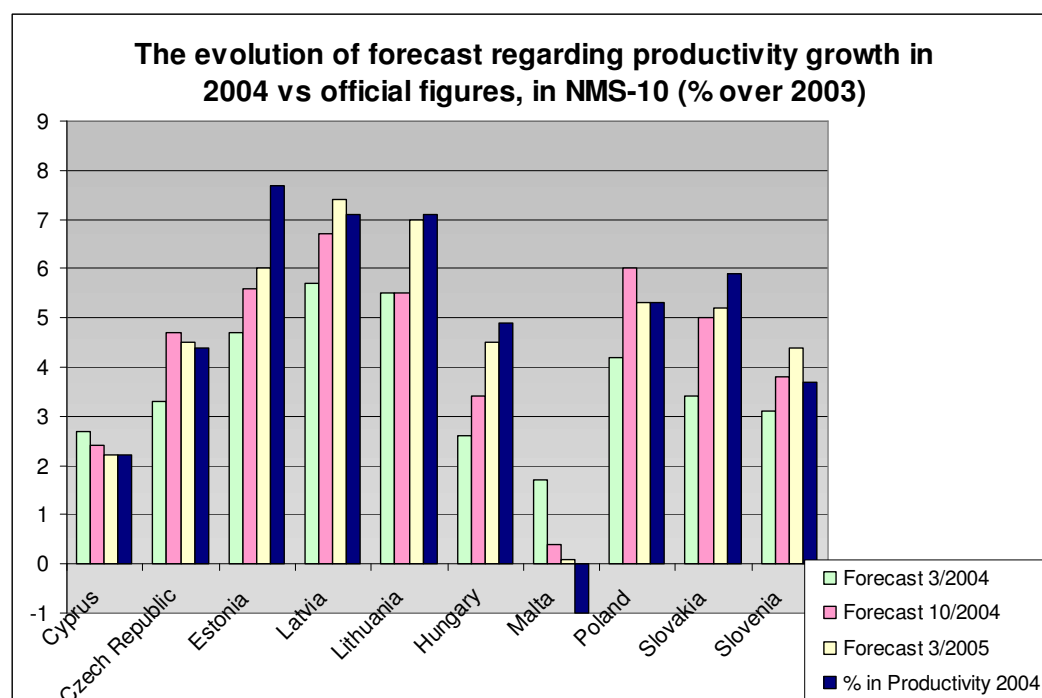
The main conclusion of this post-integration phenomenon is that any fast-growing economy making efforts to curb inflation should expect and be ready to face risks of macroeconomic disequilibrium consisting of widening gap between an explosive demand and an inertial domestic supply. The monetary policies, as well as the exchange rate mechanism, may be constrained by self-imposed principles of operations (such as the desire of achieving the standards of the ERM II and the criteria requested for euro zone convergence, in the case of NMS-10). The social policy tends to be expansionary in order to ensure a faster nominal convergence. Consequently, the economy will try to automatically adjust in the only area where some degree of freedom is left, that is the external balances.

The evolution of labour productivity in NMS-10 versus the previous expectations

All the eight NMS former economies in transition registered rates of growth in productivity higher than the pre-integration forecast ones in 2004. This confirms on the one hand the opportunity of taking the decision for enlargement at the particular moment it was taken and the success of the enlargement process, and, on the other hand, speeds up the convergence process towards the average EU standard of living. The only countries where the productivity decelerated lately are Cyprus and Malta (in the latter, it even diminished in 2004).

The performers were the three Baltic States, showing real growth rates of labour productivity above 7% in 2004, which gave the opportunity of raising significantly the wages without endangering the sustainability of economic growth. However, there are risks associated with the macro-results of these three countries in the area of balance of payments, as the current account deficit plunged below the threshold of 10 % of GDP.

FIGURE 2.4



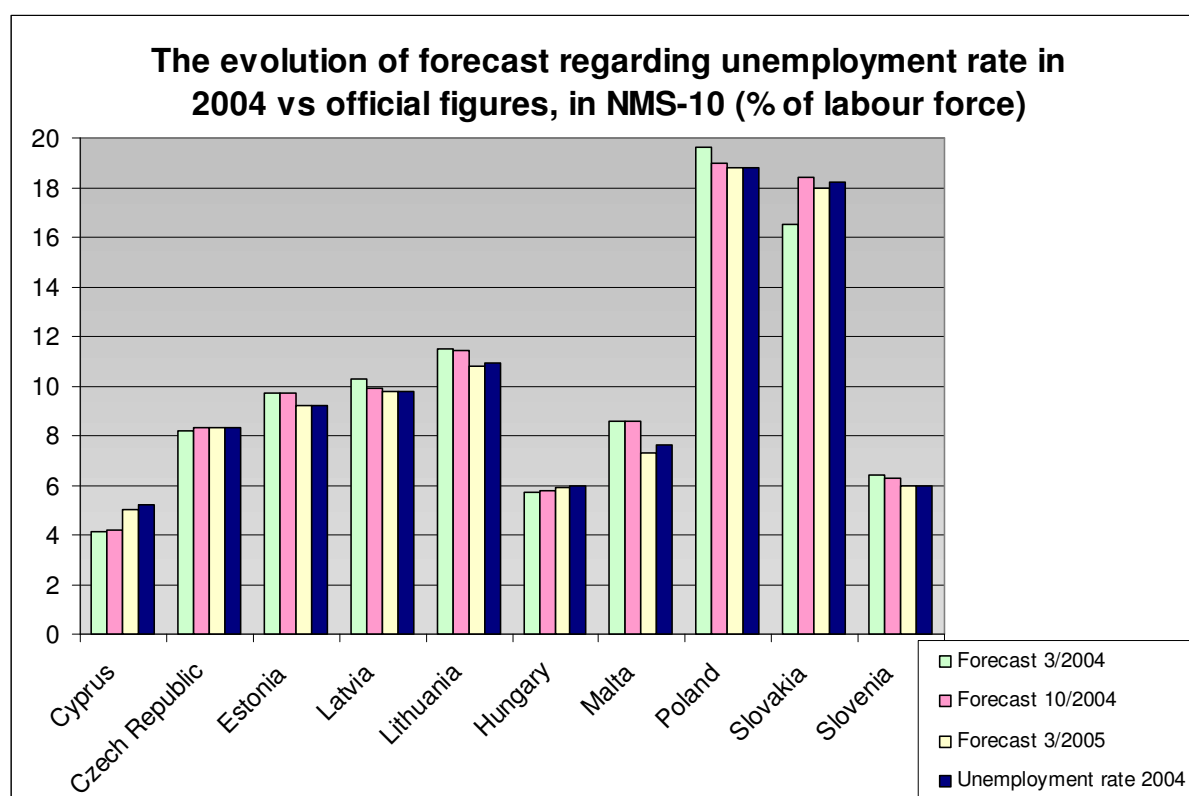
However, there are potential threats coming from the fact that, in the case of Poland, Czech Republic and Slovenia, the end-year 2004 forecast had been more optimistic than the real figures officially released in 2005 by the national statistical offices (and Eurostat). This may be the sign of a deceleration in labour productivity growth in these economies, which may hide either a saturation of the domestic supply or uncertainties on the labour market (or both).

The evolution of unemployment rate in NMS-10 versus the previous expectations

One of the positive consequences of the high economic growth in the NMS can be seen on the labour market. The forecast in the beginning of 2004 was pessimistic compared to the de facto results for 2004, as Figure 2.5 shows. It is only in Cyprus and Slovakia where unemployment rate increased last year, in absolute terms and relatively to the forecasts, which, in the case of the Slovak economy may become a serious problem, as the unemployment approaches dangerously the threshold of 20% of labour force.

The unemployment rate is not foreseen to grow in the next period for the major part of the NMS economies (as well as in the case of Romania). The reason is not so much the job creation as a result of high growth rates, but more the demographic factor, in the sense that the labour force show a clear tendency to shrink in recent years (as the ageing of population is a prominent phenomenon in East Europe).

FIGURE 2.5



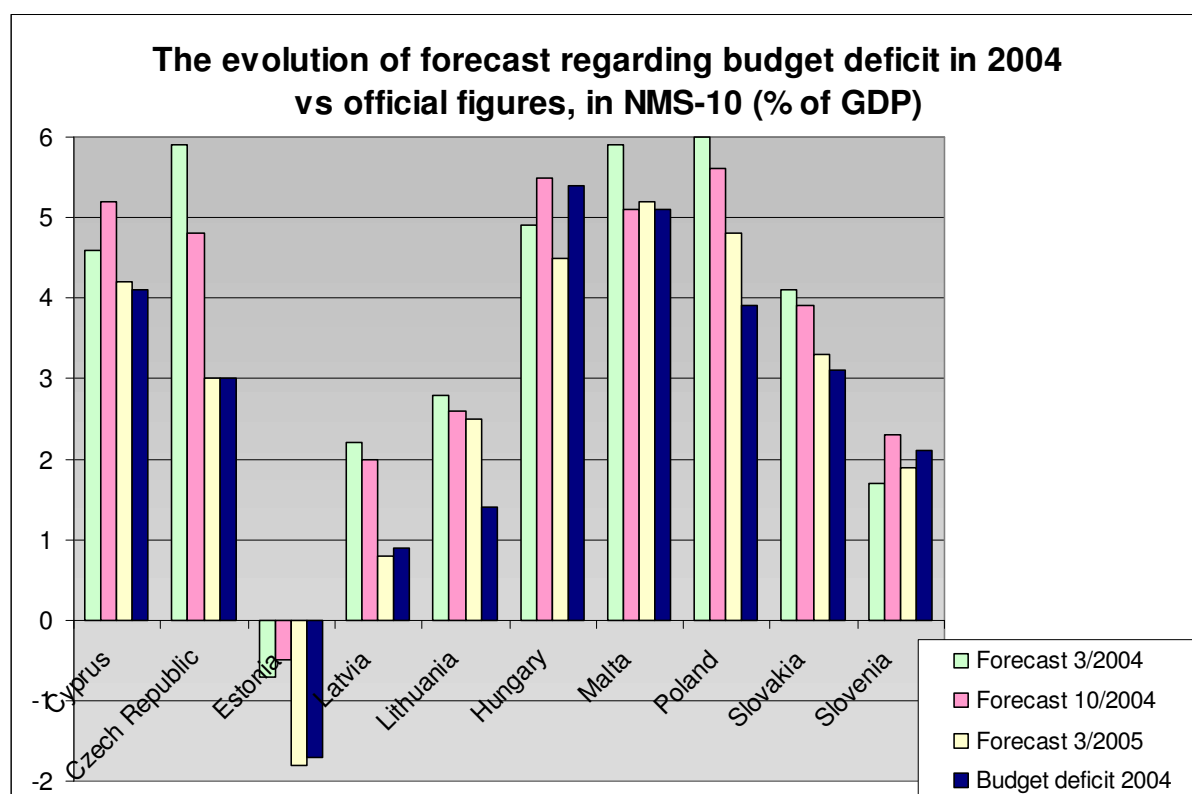
The evolution of budget deficit in NMS-10 versus the previous expectations

The short-term benefits of the integration process are obvious when it comes to budget policies. Almost all NMS had crossed periods of budget deficit explosion before their accession in 2004, fact that raised the biggest question marks in front of the decision for enlargement and its opportunity, fuelling at the same time the voice of integration opponents. Nonetheless, the most spectacular results of NMS-10 in terms of macro-economic policy achievements during 2004 are in the area of reducing the public deficits in a significant proportion. These deficits continue to be high in the case of some NMS, but they are lower

than previous expectations and forecasts, as it is shown in Figure 2.6 (exceptions are offered by Hungary and Slovenia).

In the cases of Czech Republic and Poland, the effective end-year results for the consolidated budget deficit were noticeable, as they were with 2 to 3 percentages of GDP lower than what had been expected before the moment of integration. In Czech Republic, this was in part the consequence of both changes in the accounting method (negatively affecting the balances of previous years) and of transferring budget resources from one year to the next one. However, the main factor for this positive result for all NMS is an increased budget and fiscal discipline and increased transparency in reporting the budget expenditure. The latter feature is the follow-up of the enforcement of the requirements of participation in the ERM II, allowing the easy monitoring of the process of pre-convergence towards the euro zone.

FIGURE 2.6



One may conclude that 2004 was a proof that the integration into the EU of the ten new Member States didn't produce the negative macro-economic shocks that had been announced and expected by Euro-sceptics and that most of the NMS registered at the end of the year results that surpassed many of the previous forecasts, in aspects such as GDP and productivity growth, labour market, monetary and budget policies. There is no doubt that risks still exist and potential threats to stabilisation will appear from time to time, but a good policy mix may succeed in avoiding the presence of longer-term negative phenomena, such as overheating, disequilibria and deficits, unemployment or social discontent and riots.

2.2 Conclusions

The outcomes of this study provide a meaningful message regarding the impact of the process of integration into the European Union on the economies of the New Member States, in the preceding period of the May 1, 2004 moment, as well as in the short post-integration period.

These countries ended year 2004 and entered 2005 with much better macroeconomic performances than the anticipative expectations of most analysts and decision-makers.

The main conclusions are synthesised below, aiming to present the most significant lessons offered by the recent enlargement of the EU, in the perspective of the imminent integration of Romania's economy:

At economic level:

- 1. The enlargement of the EU with a number of ten New Member States did not produce any major disturbance in the functioning of the European Union's economy, in its former structure or at the level of each NMS economy apart.**

The worries put forth before the integration of the ten NMS did not prove, in broad lines, to be legitimate. As regards the gross domestic product increase, the increase of labour productivity, inflation rate and the long-run increase of the interest rate and budgetary deficit, the prognosis of the European Commission and the assessments of the governments of the NMS, stated in the Monitoring Reports, were pessimistic as against the actual macroeconomic outcomes registered in the end of 2004. Regarding the rate of unemployment there were no significant variations neither against the forecast, nor in relation to its levels in the previous years. Instead, a quasi -generalised impairment of the trade and current account deficits have been noticed, as compared with the previous levels, and the forecasts, as well.

The New Member States of the EU registered in 2004 an average growth rate of their gross domestic product of around 5%, much higher than the average growth rate in 2003 for the same 10 countries (3.7%). For 2005, the late forecasts of the Commission estimate lower rate, around 4%, which represents, anyway, twice the rate forecasted for the old Member States of the EU-15. We may assess that the NMS-10 entered the EU in a peak moment of the growth dynamics within the economic cycle. After an economic deceleration period in 2001-2002, due to an unpropitious international environment, and some errors in choosing the set of domestic socio-economic policies, as well, recovery followed, in a smaller way in 2003 and very clearly marked in 2004. The growth was all the more so evident last year when taking into consideration that the economies that exceeded expectations at the farthest were the largest economies in the area: Poland, the Czech Republic, Hungary and Slovakia. Another important aspect is that – excepting the smallest two NMS, Cyprus and Malta – the economic growth was balanced and distributed at the level of every segment of the aggregated demand. So, the beneficial effects of a high demand coming from the traditional export markets of the EU-15 combined with the ones generated by the increase of private consumption and the recovery/ strengthening of the domestic gross fixed capital formation. As a consequence, **the macroeconomic outcomes helped in narrowing the differences of gross domestic product per inhabitant existent between the economies of the EU-15 and the ones of the NMS, facilitating the process of nominal and real convergence.**

- 2. The imminent and – in some cases – *de facto* participation of the NMS to ERM II represented the most important factor in the macro-stabilisation of these economies, the strengthening of fiscal discipline and bringing inflation under control.**

All the New Member States of the EU expressed their special ambition to enter the European exchange rate mechanism ERM II with a final view to integrate as soon as possible in the EURO area. Six of the ten states have already lined up with this mechanism – Estonia, Lithuania, Latvia, Slovenia, Cyprus and Malta – and are hoping to access to the EURO area before 2009-2010. The other four states, not accidentally the largest of the ten NMS, are facing some difficulties in fulfilling the conditions requested for the participation to the ERM and, consequently, estimated slightly delayed moments, as compared to the other countries, for getting in line with the requested standards. As regards Hungary and the Czech Republic,

additional delays, generated by derails in the budgetary, fiscal and inflation management policies, have already been announced.

In spite of some failures displayed in the case of some Member States, like the macroeconomic overheating that induced short inflationary peaks and resulted in an average inflation of the area higher in 2004 than in 2003, or the maintenance of some budgetary deficits relatively high as against the gross domestic product, the comparison between the effectively obtained results and the foregoing prognosis demonstrates inflation figures lower than the foregoing expectations for every NMS (excepting Latvia and Poland) and weights of the budgetary deficit consolidated in GDP lower than the expected ones (excepting Hungary and Slovenia). Summarised with the spectacular outcomes in the economic growth sphere, these performances led to the global decrease of the public debt in the NMS, which gives promise for a transition without problems towards the EURO area. The conclusion is that, regardless the precise moment when these states will enter the EURO area and independently of the regulations that will govern the functioning of this monetary area at that moment, the New Member States already feel and will continue to feel the benefits of the increased transparency at the level of their public budgets, of the inflation aiming process or of the process of fixing the exchange rate against the European currency.

The extent of price convergence in the Member States of the European Union is considered an indicator for the functioning manner of the Domestic Market of the EU. *The speed-up of the economic activity in the New Member States, in the foresight of the accession to the EU moment, was attended by the increase of the general price level.* Consequently, the prices in the New Member States approached the EU average, contributing to the general price convergence.

3. The labour market in the NMS did not witness major changes, demonstrating certain inertness to important variation of the other indicators in the economy and in the society, generally.

Despite an impressive increase of the gross domestic product, not many jobs have been created in these economies in the period 2004-2006. Due to the descending trends at the active population level, this did not result in a negative repercussion with regard to the unemployment rate; actually, the unemployment rate kept ahead of high levels, mainly in Poland in Slovakia, countries where the indicator is approaching 20%. A factor with negative impact was, in this respect, the requirement of restructuring many small and medium enterprises in the NMS in their try to survive the higher competition encountered at their entry on the Single European Market. The weight of unemployed people - on the long run – in the labour force total was practically changeless between 1999 and 2003 at the EU-25 level (around 4%) and integration did not bring major changes in this labour market indicator. Besides, except for Poland and Slovakia (cases where the long-term unemployment rate exceeds 10%), the New Member States of the EU registered, in fact, a significant decrease of the long-term unemployment in the period preceding their integration, which seem to have continued after integration as well.

The inertness inherited from the pre-transition system by eight out of the ten New Member States with regard to the labour force market, evidenced by a reduced mobility of the labour force and a disposition of cultural-educational nature to stability, resulted in a migration flow more depressed than the one expected by the developed economies in the EU, even in the circumstances when certain states (Great Britain, Ireland, Denmark, Sweden) did not impose significant barriers for the mobility of the labour force coming from the NMS, not even in the first post-enlargement years.

4. The enlargement of the EU stimulated the external trade both between the NMS themselves as well as between the NMS and EU-15. However, as a consequence of the impact of the Single Market, generating enhanced competition and high growth of

demand in NMS, the imports of these countries have increased more rapidly than the exports in most of the cases, significantly worsening the trade deficit and, especially, the current account deficits.

The external trade balances is the only area where the actual results were significantly below the most pessimistic forecasts. For some countries (Baltic States, Malta, Cyprus) the current account deficit approached or even surpassed the level of 10% of GDP, rising doubts about the perspectives of the long-term sustainable growth and the external debt, currently on a growing trend.

The imports continued to grow at a pace of over 10% in most of these countries, following a growth of private consumption and investment that created very favourable conjunctures for many economic agents in EU-15 countries. Generally, exports of NMS decelerated, especially in 2005, due to the real and/or nominal appreciation of the national currencies and weaknesses in the EU-15 economies (as the main trade partner). The only remarkable exception was the Czech Republic, where exports were the driver of growth in 2004.

5. **The structural funds transferred from the EU to the NMS enabled the reinvigoration of investments, facilitating the modernisation and expansion of the infrastructure networks. Also, the qualitative development of the human capital was catalysed by an important part of these funds. For all that, these funds were not equally efficient allocated and used in all the Member States and the long-term effects may differ considerably** according to the category of funds and its weight and according to the absorption capacity of the state managing the funds.

In 2004, over 3.8 billion EURO were effectively transferred (paid and used) to the ten New Member States. The own mandatory efforts of the NMS, related with the European transfers, are to be added to these funds. Of course, the use of these funds, and their allocation by structural categories were initially subject of negotiation, according to the interests of each NMS, on the one hand, and those of the EU on the other hand, and their absorption dependent upon the management capacity of each NMS government and the political interests in the short, medium and long run.

The allocation by categories of the structural funds is very different from one state to another. In Poland, the regional and rural development fund represents almost 53% of the total of 8,3 billion EURO accepted to be paid by the Commission for the period 2004-2006. Also, the fund intended for human capital is larger than the ones intended for the enterprise sector or for infrastructure (in the circumstances of the existence of an additional Cohesion Fund of 4,2 billion EURO allocated for Poland, to this effect). In most of the other states, the human capital development fund has a weight of no great size (generally, less than 20% of the total, except for Slovenia, Hungary and Cyprus), showing that the positive lesson offered by Ireland and by its strongly ascending route in the post-integration period was not very well assimilated by the governments of the new states, influenced by the internal lobbies and the short-term policies.

One of the most important categories – in both the pre-accession period and the post-accession one in the case of some states like Poland, Hungary, Latvia or Slovakia - among those forming the structural funds, appertaining to Objective I (intended for the diminution of the gaps between the behindhand regions and the EU average) is represented by the funds intended for the restructuring of agriculture and development of the rural areas. Eurostat estimated that in 2004 the average yearly income of the rural household in the New Member States of the EU increased by over 50%.

6. **Although seen generally as being a barrier to the competitive functioning of a free market and despite they are not allowed within the EC Treaty, the state aid may be authorized to be granted under very special conditions, when inducing sustainable**

growth or when correcting intrinsic market failures or deficiencies. After the last enlargement round, the EU state aid policy aimed with priority at correcting those market distortions in areas such as innovation, knowledge economy or environment protection.

The new Member States, and most of all the eight previously transition countries, have inherited industrial structures which functioning was heavily dependent on subsidies, fiscal exemptions and monetary easiness. The granting of state aid to those traditionally subsidised sectors that were carrying high risks for the labour market (concentration of workers in relative small geographical areas) or were having a strong horizontal impact on the overall economy (steel industry, machinery & equipment) had been negotiated for a long period. It has been authorised for prolongation (waived) during several years in the case of larger NMS which had asked for it (Poland, Slovakia, Czech Republic). However, the monitoring process on the European Commission side was carefully conducted, leading to the opening of several special control procedures – two cases of apparent non-compliance – and having unpleasant consequences to the evolution of bilateral relationship between the EU and the respective new Member States (such as a diminished power of further negotiation).

Despite the envisaged reduction in the range of sectors to be addressed by it, the state aid policy may become useful in orienting funds and other resources to those innovative emerging sectors that may have major prospects of durable growth, but currently lack the necessary financing and resource infrastructure, as well as the required business environment, which may allow the non-distorted functioning of the market and could foster the fast development of efficient and competitive economic agents.

At social level

1. Joining the EU does not imply adopting a certain model of social policies, allowing to the member state to choose their preferred mechanism of social protection.

In the case of the NMS, the only potential restriction that might occur during the pre-adhesion negotiation period is the recommendation of coordinating the social policies between the NMS and EU-15 so that at the end of the enlargement period all the necessary conditions for the free movement of the labour force within the borders of the EU to be fulfilled.

In this respect, *the main trends* emergent from the mid '90, amplified and deepened, namely:

- *Slow withdrawal of the state from the management of social protection specific activities:* elimination of several types of subventions on basic goods and services, privatisation and market-isation of a part of health and social insurance services, incentives for the NGOs;

- *Institutional separation of the social security budgets:* social security budget is separated from the state budget, pension funds are separated from the health insurance budgets; the social protection policy is implemented by a number of independent bodies, while the power and responsibilities of the local administration institutions were extended.

2. The reforms implemented by the governments of NMS in the pre-accession period were meant to eliminate the state monopoly, stimulate an increase in the number of the services providers, decentralise the management of the system. These reforms have been implemented on the basis of a nominal and real growth of social protection expenditures, both in absolute and relative terms (as share in GDP).

During the period that preceded the adhesion, the social expenditures in the NMS were much below the average level in the Western Europe. At the beginning of 2005, the spread between the average social expenditures/inhabitant in the EU-15 states and in NMS-10 was 3 to 1 in PPP terms. This broadly corresponds to the maximum spread between within the group of NMS countries, with average social expenditures/inhabitant (in PPP terms) ranging from only

1100 Euro/year in Latvia to 4000 Euro/year in Slovenia, country that inherited an already performing social security system from the pre-transition period.

Nevertheless, a certain tendency of convergence in the levels of social security expenditures towards the west European levels (around 28% of the GDP), could be observed. Otherwise saying, the new member states make efforts to transpose the European social model, although at lower levels of revenues. In the case of NMS, the share of social security spending in GDP has varied between 25.5% in Slovenia and only 14% in the Baltic countries. The tendency of convergence speeded up in the few years prior to the integration.

The reforms of the social protection systems had also negative effects, especially in an increase of the social inequality and of the burden of social support towards families, especially towards women, which in turn strengthened the negative demographic trends.

- 3. There is a certain tendency of concentrating the social policies in the new member states towards the short-term objectives, particularly unemployment. Nevertheless, many of these countries spend more than their EU-15 counterparts for education, which is a warranty for future. On the other hand, health sector remains one of the most difficult issues to be solved in short, medium and long term.**

Structural changes took place to respond to the new needs. If at the beginning of the '90ties the direct expenditures for social protection and unemployment benefit were seen as relatively small as share in the total social security budget, the situation changed after 2000, when the NMS increased other expenditures on social insurance as those for social protection, family support schemes and various unemployment benefits.

The differences between the social security and pensions systems implemented in various NMS led to significant differences between various types of pensions in these countries, both in nominal and relative terms (Hungary and Poland having low pensions as compared with the situation in Slovenia and Czech Republic).

Health insurance and social protection systems are in a process of convergence, but, at the end of 2004 significant differences between the public financing of the health systems existed as well. While Latvia finances the health system with only 2.5% of GDP, the 7.5% in Slovenia was above the EU average.

- 4. Social transfers in the NMS tend to reduce the difference between the poverty levels within the group as well as between the NMS and the EU-15. In the same time the share of the population in poverty risk is lower, as well a statistical effect of low average revenues in these countries.**

The NMS face serious challenges, as they still need to restructure the industrial and agricultural sectors and, without counteracting the restructuring with appropriate social policies, the inequality and poverty levels might rise.

At institutional-legislative level

- 1. In the context of the debate on the experience of the new Member States in implementing the *acquis* it is necessary to draw a distinction between the transposition of the *acquis* into national law and its actual application – the latter task involving both the administration and the judiciary, the role of the national courts in this sense being essential.**

The new Member States have in general already absorbed the *acquis*, but there is still a long way towards the effective application of Community legislation and clarifying the related technical issues. Legal harmonisation does not end upon accession, it is a dynamic process of mutual transfer of knowledge and best practices.

On the transposition of the *acquis* in the new Member States, we note that, on the one hand, several of the older Member States themselves encounter serious difficulties in this respect, and on the other hand, from a comparative standpoint, so far the performance of the new Member States in this respect seems to be better (at least according to information available at the date of writing).

The Internal market does not bring immediate benefits. Its rules must be adopted, transposed into the national law of the Member States and applied, so that the business community and the citizens can draw benefits from it. If the Internal Market does not work effectively, its contribution to the growth and competitiveness of the EU will be limited. It is thus important to transpose the Internal Market directives on time and in a satisfactory manner.

2. The European Commission has the power to control and monitor the legal harmonisation process. It counts on at least eight distinct methods of control and monitoring, but the preferred method is that of the *Annual Reports on Monitoring the Application of Community Law*.

Besides the formal instruments established in the Treaties through which the EU institutions (the Commission and the ECJ in particular) can exercise their control over compliance by the Member States with their obligations in terms of transposing and applying the *acquis*, there are a number of “informal” means to attain the same objectives.

According to information available up to 2003, the largest share of sanctioning procedures opened by the Commission for unsatisfactory transposition of the *acquis* are related to EC rules for the Internal Market and environment. Other areas where the new Member States encountered difficulties in the transposition of the *acquis* are: fiscal policy, budgetary issues, energy and transport.

One year after accession, the Commission had already opened sanctioning procedures based on Article 226 EC against some of the new Member States (Poland in particular) for non-compliance or unsatisfactory compliance with the obligations related to transposing the *acquis*. The number of such sanctioning procedures is, however, relatively reduced by comparison to that of sanctioning procedures against older Member States.

3. In 2005 the EU-25 registered an average annual deficit in the transposition of Internal market directives of 1,9 %, compared with 7,1 % in 2004. The new Member States performed in this direction better than the older Member States, although they had to absorb in a very short time the entire *acquis*. The new member States have relatively shorter delays in the transposition of the *acquis* than the older Member States.

At the level of the EU-25, 11 countries managed to attain the target of keeping the transposition deficit within 1,5%. The Commission mentions the top performers in the following order: Lithuania, Hungary, Slovenia, Denmark, Finland, Malta, Germany, Spain, the Slovak Republic, Sweden and the UK. Other countries, such as The Netherlands, Poland, Cyprus and Austria are getting closer to the 1,5% deficit target.

Although the Czech Republic, Latvia, Estonia and France are not close to reaching the 1,5 % deficit target, they made important progresses by comparison to the situation in 2004, but their deficit levels remains high: 23,6 %, 19 %, 8,3 % and 4,1 %.

4. On the role of national courts in the application of the *acquis*, we underline the essential support received in complying with this task from the ECJ, through the preliminary reference procedure.

In the same context, the preliminary reference mechanism offers *inter alia* a supplementary guarantee of the independence of the judiciary. According to studies on the functioning of the

preliminary procedure mechanism until the mid 1990s, a good share of such procedures are traditionally related to the application of EC law in the areas of agriculture and the Internal Market (freedom of movements for goods in particular).

According to information available at the time of writing, the courts of the new Member States have not yet started to take full benefit of the preliminary reference procedure. This is not unusual, however, as an initial period of “adjustment” was also observed in the case of preceding enlargements. Moreover, statistics on the use of the preliminary reference procedure show that in reality the number of such procedures is never as high as one may expect.

Besides support from the ECJ through the preliminary reference procedure, the national courts can count in performing their tasks related to applying the *acquis* on the formal and informal support of the Commission. This chapter discusses, by way of example, the cooperation between national courts and the Commission in relation to the application of EC competition rules. The chapter briefly comments the reasons why the role of the national courts in EC competition law enforcement is relatively reduced.

5. The reforms undertaken in the new Member States with a view to consolidating the capacity of the judiciary system to apply the *acquis* multiplied in terms of means and coverage during the years preceding accession.

* * *

As a final conclusion, we should add the fact that the process of gradual convergence that is taking place following the EU enlargement with ten new Member States is associated with many uncertainties and question marks for policy makers and is also carrying risks related to the changes affecting the social, political, cultural and economic stance of the enlarged EU. A few of these threats and challenges, which already showed up during the short period of 16 months since 1st of May 2004, are summarised below:

- The restructuring process affecting large enterprises (inherited from the previously centralised system) and the relatively sudden exposure of the national business environment to the competitive pressures of the Single Market has produced and will continue to produce negative shocks to certain sector segments of the labour market. Such short-term instability spread across some major economic sectors and affecting several micro-regions may end up in political instability during the next few years (as it was actually the case with Poland in 2005). The ultimate outcome could be a dampening of the reforming appetite of the new Member States and a trend reversal in the speed of adopting and implementing the Community legislation, followed by delays. Once started, the phenomenon could end up in a vicious circle.
- The on-going upward alignment of prices in NMS to those governing the European Single Market (particularly in the case of tradable products) will maintain the inflation rate in these countries higher – on the average – than the average inflation rate of the EU-15, automatically delaying the integration into the ERM II due to constraints in complying with the criteria related to inflation.
- The higher the similitude across EU economies (including the new Member States), which will lead to quasi-simultaneous business cycles having as result growth deceleration, at least during recession periods, the slower the process of nominal and real convergence of NMS economies towards the EU average living standard will be.

However, beyond risks and threats, the analyses within this study point out at the existence of many more opportunities that the recent enlargement has opened for the EU Member States

on their road towards sustainable development. A few of these advantages and opportunities, which were not mentioned earlier in this study, are mentioned as follows:

- Being a part of the European Union brings to the new Member States better image and higher credibility associated to their global business environment and to their financial and banking system. The financial and fiscal positions on international markets of the NMS have improved in recent years. Consequently, the access to financial resources is easier and the bilateral flows of foreign investment are forecast to grow in the medium and long term.
- In recent years, in Western Europe (thus including EU-15), the number of employees in micro- and small-sized enterprises has increased – in relative terms – while decreasing in large enterprises. The explanation resides with the fact that SMEs in Western Europe are very active in those economic sectors that are labour-intensive, such as public services, trade, etc. In NMS, there have been changes in the structure of employment by size of enterprise, which are different from the ones registered elsewhere. The main difference is related to the increase in the role of medium enterprises (partially of small ones) in creating jobs, but the sharp decrease in the number of employees in micro-enterprises. It is probable that, as time goes by, we will witness a process of convergence in this area like in all other areas of social and economic development, which will lead to an increased job creation capacity of the NMS in the long run.

We will conclude this analysis by saying that, since 1st of May of 2004 the enlarged European Union had gained on some aspects and had lost on others. It indeed gained economic, social, political and cultural power in absolute terms. It became the leading economy in the world. It has strengthened its leading world trade partner position. It is undergoing an extraordinary project of building homogeneous and complex infrastructural and supra-structural networks covering the entire European continent and population (these include financial-banking network, communication and information networks, transport structures, etc.) However, it lost a little bit in average efficiency, average productivity, macro-stability, particularly in the short run. It has lost further flexibility of its labour market, which anyway was below the levels in other developed world economies. The authors of this study hope that all the above analysis succeeded to give the message that – despite threats – there are only a few areas of interest in which the enlargement may produce negative effects in the long-term perspective. Maybe we could think of the potential specialisation of intra-EU trade? Should we expect that the real estate financial bubble expand towards East? Will some of the current frictions between Member States become permanent leading to a decrease in the credibility of the pan-European dream? The majority of the signals following the accession of the ten NMS contain a positive message: 300 thousand new jobs expected to be created within the NMS economies in the following years; a rate of real and nominal convergence above expectations; an increased fiscal and budget discipline; one single currency in use in the near future, having big chances of becoming the leading world currency in the next decade; legislative harmonisation within the EU happening at a higher pace than before the enlargement; an enhanced security for the European citizen, who will enjoy higher mobility within the overall European Area. In the end, there will be higher chances that the European common social, cultural, political and economic system enters a sustainable growth path!

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