NEGOTIATING EU MEMBERSHIP: THE EXPERIENCE OF BULGARIA AND HUNGARY

Under the above title a bilateral Bulgarian and Hungarian meeting was held on 28 May 2004 in Sofia. The meeting was initiated by the Economic Policy Institute (EPI-BG) in Sofia together with the Institute of Economics at the Bulgarian Academy of Sciences (IE-BAS). Researchers from the Institute for World Economics at the Hungarian Academy of Sciences (IWE-HAS) have presented papers.

The meeting was organised in four sessions. In the first one titled *"Macroeconomic Development"* two basic papers were delivered. Prof. Andras Inotai, Director at the IWE-HAS considered key issues of Hungary's EU membership. At the beginning the author presented briefly the pre-history of EU integration. At the first stage the Hungarian strategy opted for integration with the international financial institutions, while having made the institutionalization of relations with the Community dependent on the outcome of official negotiations between Brussels and Moscow (EC and CMEA). He pointed out the issues of implementing those requirements that are the precondition to become a successful EU member within the immediate future. This success can be measured at two levels. *First*, a large part of Hungarian society has to feel within a relatively short time that EU membership means feasible enrichment and accelerated catching up with the EU average. *Second*, it can be considered a success when Hungary develops an active, future-oriented policy line in EU by strengthening European competitiveness.

However, „integration maturity” has to be approached from other points of view as well. Among others, such criteria are (a) the development of real economic processes, (b) a comparison with the „integration maturity” of neighbouring and of already member countries, (c) the prospects for a successful membership in the enlarged Union in the context of current and expected community economic policies, and finally, (d) as compared to the global requirements of competitiveness.

In Prof. A. Inotai' view any comparison with previously joined members is wrong and „ahistoric”. Firstly, both the global and European environment have been fundamentally changed as compared to the period where Greece was „admitted”, and Portugal and Spain joined EU.

No country that has joined the European integration at any time was fully prepared for membership. Successful economic integration has some non-economic components as well. In brief, four factors have to be considered. *First:* during the first decades of the 21st century the importance of non-economic factors of international competitiveness is increasing globally. This is particularly obvious in two areas. On the one hand, the quality of public administration, not only at central but also at regional and local levels, is becoming a key factor for success. On the other hand, the role of social flexibility, and even more, that of social cohesion will be upgraded, particularly in small(er) countries. *Second*: successful involvement into the community-level decision-making process, the gradual expansion of the Hungarian maneuovring room within the EU can become a relevant precondition for a successful economic integration. *Third:* an indispensable condition of economic success is that Hungary possesses a clear and flexible integration strategy in all areas covered, or to be covered in the future, by community policies. In this case there is a possibility only to play an active or shaping role in the decision-making process of the EU and to „direct” EU policies according to Hungarian priorities. *Fourth:* the cornerstone of any sustainable economic success is the readiness of society to changes.

Prof. Ivan Angelov (IE-BAS), a corresponding member of the BAS discussed the strategic challenges confronting the economic development of Bulgaria. They were divided into two basic groups. The first group of challenges concerns the preparing for joining the EU in medium term, i.e. over the next 5-6 years. During this period the policies dominated by the national state will gradually change to policies leading to restrictions on national sovereignty. Medium term challenges are as follows:

- Rapid accelerated development including GDP growth rate of 6-8% per annum;
- Higher investment activity aimed at accelerated economic growth, and structural and technological updating of the economy;
- Implementation of flexible budget policy helping accession;
- Creation of functioning and competitive market economy;
- Reduction of current account deficit up to 4-5% of GDP mainly through reduction of the trade balance deficit;
- Convergence of prices to average EU level;
- Preparation for absorption of EU transfers;
- Development of modern institutions and public administration;
- Curtailment of crime and corruption.

The second group of challenges RE long term (up to 2020), and they are connected with mitigating of the backwardness of the Bulgarian economy and its development to a medium developed market type economy. There were identified long-term challenges that Bulgaria will face before achieving functional and institutional integrity as a EU full member. They are the following:

- Achieving catching up economic growth from 5 to 5.5% annually;
- Development of intensive economic activity on the basis of important quantitative and qualitative improvement in rates of investment and accumulation;
- Raising productivity and competitivenes of the economy;

• Structural adjustment of Bulgarian industry - updating of the sectoral, branch and first of all production pattern. Rapid increase of the proportion of the medium and high-technological products to the detriment of low-technological;

• Technological updating of the economy - active innovation policy directed to the latest technological sectors: ICT, bio-technologies, ecologically pure technologies, nanotechnologies, new materials, new energy sources;

• Increasing income and consumption of the population, structural improvement;

• Development of the health-care system;

• Catching up development of education and science, endeavour to achieve overall literacy;

• Achieveing catching up regional development in the context of catching up economic growth; delay of further regional divergence as a result of higher economic growth;

• Mitigating the social polarisation tolerating a moderate differenciation in the society;

• Gradual mitigating of the negative consequences of the demographic crisis and getting control of it;

• Breaking up the negative functional relation between economic development and environment;

• Curtailment of the economic crime and corruption.

Summarising the author stressed that nowadays Bulgaria is among the most backward economies in Europe. If the country is not able to cope with the challenges pointed out it could not be turned into an equivalent member of the enlarging EU over the next 20-25 years.

In the second session *"National Competitiveness"* two papers were delivered. Andrea Szalavetz (IWE-HU) devoted her paper to the structural competitiveness of the Hungarian economy. She sought answers to theoretical, methodological and descriptive research questions. The theoretical questions she tried to answer were the following: To what extent is economic structure related to competitiveness and growth performance? Is there such a thing as "structural competitiveness"? The main finding of the paper is that in the long run it is not important what countries specialize in, although that matters, but rather the quality properties of the economic activities. In the short and medium term "good specialization" can spectacularly improve the *performance*, but not the *competitiveness* of a country.

The methodological question in the paper concerned the analytical value of individual structural indicators. What could these indicators shed light on and what do they conceal? The analysis was based on Hungarian structural data, since the paper tried to find out whether and in which way the Hungarian structural changes fit into global tendencies.

Irena Mladenova (EPI-BG) considered some key aspects of Bulgaria's competitiveness. She emphasised that Bulgaria, being part of the eastern enlargement, can benefit and learn lessons in terms of predicting the impact on its competitiveness, taking the necessary measures to benefit from and contribute to enhancing the competitiveness of enlarged Europe. In her view competitiveness measures and compares how effective countries are in providing business environment that sustains the domestic and international competitiveness of businesses. The competitiveness of a country is different from its comparative advantage(s) and has various dimensions, referring to economic performance, government efficiency, business efficiency and infrastructure.

There are various approaches to assessing competitiveness. I. Mladenova discussed three important factors which together interact to support (or hinder) the generation of economic growth: (a) macroeconomic environment; (b) institutions; (c) technology. She paid special attention to investments as a source of improving competitiveness through technology transfer, building human capital and generation of economic growth. In this aspect there are a number of basic points:

- The South East European (SEE) region attractiveness for foreign investors increases, especially after the enlargement. The coming EU-membership perspective for Bulgaria in 2007 gives additional guarantee and stimulus for investors. The country opens doors to new markets further south and east, and has the advantage of knowing the local markets.
- The pattern of investment is changing. There are fewer privatization deals because the privatization process has been largely completed. The challenge would be to attract more green-field investors. Also, existing investors are expected to invest in expansions and modernisations.
- Enlargement is hoped to contribute to the Lisbon process, mainly thanks to the newcomers' potential for growth and experience with economic reforms. The creation of an internal market of 450 million inhabitants, 300 million out of whom use the same currency, will lead to greater intra-Community trade and provide new opportunities for investment and industrial organization which will benefit from the assets of not just the current but also the new member states.

However, while foreign investments and EU aid help, economic development will, as before, depend largely on the efforts of governments and local entrepreneurs. In order to take full advantage of these opportunities, Bulgaria should encourage investments, and actively invest especially in the following areas: human capital (including education, life-long learning, vocational training), technology – R&D, technological adoption and innovation, and entrepreneurship.

The third session *"EU Enlargement – Financial Aspects"* included the biggest number of papers. Prof. Garabed Minassian (IE-BAS and Bulgarian

National Bank) presented a paper "The Exchange Rate Regime and the External Debt". At the beginning he followed the changes in the volume of the Gross External Debt (GED) in Bulgaria since 1980 up to now. After that the author has considered the following factors for changes in the debt burden (GED/GDP):

• *Nominal value of GED*, as the rule is the higher the GED, the larger the debt burden;

• *Real economic growth*, where the following rule is valid: the higher real growth, the lower debt burden;

• *Exchange rate EUR/USD* - it could have different impacts;

• *Real Effective Exchange Rate* (REER), as the positive trend of REER reduces the debt burden.

The author has analysied the last factor in more details, stressing that the positive REER growth in Bulgaria meets the following circumstances: (i) the price level is 3 times lower than in the EU; (ii) the PPP measure of GDP is 2.5 times higher than the nominal measure; (iii) there exists the lowest level of salaries in Eastern Europe (about Euro 150).

The main conclusions from the study are as follows:

1. Since the crash in the mid-1990s Bulgaria has achieved a significant progress in its debt reduction. By 2004 however, a number of CEE countries have already overtaken Bulgaria in terms of the size of their debt burdens.

2. The positive growth of REER has had a major contribution to debt reduction in Bulgaria. This positive trend of REER is likely to continue in the future.

3. The tendencies revealed in the recent developments of GED require serious monitoring. The growth in both the private and short-term debt is to be carefully observed and examined.

András Bakacs (IWE-HAS) analysed the problems of Hungary's monetary and fiscal policy adjustments upon EMU accession in an international comparative perspective. For this purpose he has considered firstly, basic macroeconomic indicators for the eight CEE countries EU members since 1 May 2004, in particular inflation, interest rates, budget deficit, general Government debt, exchange rates (ER). Secondly, he has examined the relation ER-inflation (CPI) in Hungary for the period 2000-2004. Thirdly, he has compared the base rates in selected countries, indicating the very high magnitude for Hungary. The basic rates until December 2003 were as follows: Euro-zone - 2%, USA - 1%, Poland - 5.25%, Slovakia - 6.25%, Czech Republic - 2%, Hungary - 12.5% (respectively in May 2004 - 11.5%). Fourthly, he presented personal income tax rates in selected new EU member countries - highest rate applies in 2003 (in Euro), showing the very high rate for Hungary - 20 - 40% (at a comparatively low base of Euro 5300), as it is between 15 and 32% in the Czech Republic (respectively Euro 10,400), 10-38% in Slovakia (Euro 13,600), and 19-40% in Poland (16,400).

Dr. Tamás Szemler (IWE-HAS) presented the situation about Hungary and the EU budget 2007-2013. At the beginning he described the state of the art. The proposals of the European Commission (EC) for the financial perspective 2007-2013 (published on 10 February 2004) open a long and intensive debate in the EU. The changes proposed by the EC are in some cases very ambitious – a reason for discussions in itself. The EU-15 have their traditional division: six net contributors have already expressed their intention to keep the EU budget under 1% of the EU GNP well before the publication of the EC proposals; while the main beneficiaries of the budget do not share this opinion at all. And this time, the budget will be discussed by 25 members instead of 15, and the differences of the economic development in the enlarged Union will make the debates sharper than ever.

In general the candidate countries regard the proposals of the EC positively. Even if these proposals leave the ceiling of the budget unchanged, the expenditure levels proposed by the EC exceed the proposal of the net contributors by 14% in average in the period 2007–2013. The difference is in the order of magnitude of 15–20 billion Euro per year, and it is no wonder that future net beneficiaries of the budget support this higher figure. Prepared for the criticism of the net contributors, the EC document emphasizes that the proposed financial perspective is a minimum requirement if the Union wants to achieve its strategic objectives.

Strategic objectives are clearly expressed in the proposed new structure of EU expenditure. The proposed new headings – sustainable growth; preservation and management of natural resources; citizenship, freedom, security and justice; the EU as a global partner – reflect the concentration of financing for key areas of integration.

Concerning the heading of sustainable growth, new member states are convinced of the importance of the proposed sub-heading “competitiveness and employment for growth” and want to be actively involved in it. On the other hand, given their relative economic underdevelopment and their regional inequalities, it is crucial for them that cohesion policy should remain a priority for the EU. In terms of financing it means that the objective of competitiveness will require additional resources and must not be financed by regrouping resources from the cohesion objective.

Expenditure on agriculture is determined by the reform of the Common Agricultural Policy in 2003 on the one hand, and by the decision of Brussels European Council (EC) in 2002 (which set the ceiling of financing for the first pillar until 2013). For rural development, however, no such binding agreements have been concluded yet. New member states are interested in making this component financially stronger; this would also be in line with the tendency of the current financial perspective.

Given the geographical situation of most new member states (a considerable part of their borders will be external borders of the EU), they fully share the interest of the old members in the Union as an area of freedom, security and justice. The management of the control of the external borders requires adequate financial resources, but cannot be regarded as a “transfer” to the countries with external borders, as the results of an efficient (or inefficient) management can be felt by all the citizens of the EU.

The author stressed that the objective of making the EU a global partner depends to a great extent on the capability of the member states to formulate common positions in foreign policy. While this has not always been the case (let’s just think of the diverging reactions on the Iraq crisis one year ago), the intention to move towards this can just be welcome. As for new member states, they can play an important role in the relations with the EU’s direct neighbourhood; their relations with this area can be an important value added for Union external relations.

According to T. Szemler the time span of the perspective can be regarded as appropriate: 2013 is the last year of the transition period (constraints for the new members) in agriculture, and it would not be very lucky to bring these exceptions into another financial perspective. From 2013 on, however, five-year financial perspectives seem to be quite reasonable.

He pointed out that exceptions should be avoided in the budget financing. Probably, this led the EC proposal to introduce a generalised correction mechanism for budgetary imbalances. However, such a mechanism would further complicate the present system: the questions of the type “who finances the rebate of country X in the financing of the rebate of country Y?” would be multiplied. Moreover, the regressivity created by such a system could easily result in bigger contributions (in percentage of their GNP) of the relatively poorer member states than of the wealthier ones. Therefore, other methods should be found to solve the question of the UK rebate: hopefully, the more detailed report of the EC (to be released before the summer of 2004) would contain such options.

The Gábor Tury paper (IWE-HAS) considered the Central European countries’ experience in the field of foreign direct investment (FDI). He showed the FDI world tendencies at the beginning of the 21st century. In 2001 the FDI inflows were down by 41% in comparison with 2000, in 2002 they fell by another fifth, compared to the previous year, as the inflows in the developed world declined by 22%, but in CEE countries increased by 15%. The author outlined the following tendencies in the CEE: (a) FDI inflows to CEE reached a new high of 29 billion USD, rising in 9 countries, falling in the other10; (b) cross-border M&As, both privatisation related and others, were important for CEE's inflows in 2002; (c) a wait-and-see attitude by investors may explain the lower than expected level of FDI. Further he concentrated his analysis to the four Visegrad countries, pointing out the FDI inflows there as a percentage of the world total - an average of 2.2% annually over the period 1991-1996, after that dropped below 2%, and rose again to 2.8% in 2002. Evaluating this process one can conclude that anticipated EU enlargement has had a positive impact on FDI inflow in these countries. The analysis was focused on two basic industries - automobile and electronics. For the former industry the following specific features exist; (a) growing automobile industry: in Slovakia by PSA; (b) the expansion of existing projects: e.g. by Audi and Suzuki in Hungary, Volkswagen and Irisbus in the Czech Republic; (c) strong competition is observed to obtain the last big investments of the South Korean company "Hunday". The electronics industry in the Visegrad countries faces global overcapacity and cost competition by East Asia as well as restructuring towards higher value-added activities: e.g. in Hungary Flextronics, IBM and Philips.

The fourth section was titled *"European Policy towards South and Eastern Europe (SEE) after the Enlargement".* Tamás Novak (IWE-HAS) developed Hungarian strategies towards the SEE region taking into account the specificity of the relations between Hungary and the region on the one hand, and the capacity of Hungary as a EU member, on the other hand.

In her paper Elitsa Markova (EPI-BG) briefly described some chances and limitations for the SEE countries in the process of European integration, taking into account their level of economic development, structural specificity and geographic allocation of the countries under review.

Maria Lazarova shortly outlined the Bulgarian foreign economic relations with SEE countries in the context of EU enlargement.

The paper of Milkana Mochurova (IE-BAS) reviewed the negotiation progress on Chapter "22" Environment and the major requirements stipulated by EU environmental directives. Total environmental expenditure in Bulgaria was analysed and it was compared to the necessary investments to ensure compliance with the EU standards. The author considered the roles of public and private sectors in the context of EU accession. It has proved the necessity to change the existing attitude that environmental financing concerns only the government; it should raise the awareness of the private sector and its responsibilities as well as providing support to private investment activities. She outlined areas for improving the management of public financial resources in the pre-accession period were outlined.

Rossitsa Rangelova, Senior Research Fellow, Ph. D.