

Assessing Impact of EU Membership on the Baltic States

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Mr. Chairman, Ladies and Gentlemen,

Let me start by saying that it is always an honour and a pleasure for me to speak in the same panel with Dr. Andras Inotai who is one of the best-known experts in this field. First, I have been planning to present an overview of the results of the research conducted recently in the area of integration impact assessment. However, I think it would be more interesting and hopefully more provoking to structure my presentation around the statements on what I see as the main tendencies in this area.

1. The competitive forces of the EU are less of a problem in the accession countries than used to be widely feared.

The ability to withstand the forces of competition after EU accession is one of the main criteria for EU membership. While many analysts, and EU officials in particular, expressed concern that the economies of the accession countries have not been ready judging by this criteria, the recent tendencies prove to be contrary. These tendencies are the following.

First, the openness of the accession countries and Baltic States in particular. The openness is usually measured by a share of foreign trade to country's GDP which in the case of the Baltic States is around 100 percent or more. Also, the level of trade protection is another illustrative measure of openness to foreign competition. Differently from some Central European countries, all Baltic States are less protectionist than the EU. This is most evident in the case of Estonia but also true in the cases of Latvia and Lithuania. The most recent studies in Lithuania illustrate that the level of protection would increase after joining the EU (if one is to use data from 1999, the imports from 14 third countries would become more expensive by 90.15 million Litas and some would become cheaper by a total of 10.83 million Litas), while exports would also become more expensive (respectively 27.9 million Litas and decrease by 0.37).

Second, constant increase in exports to the EU also indicates the ability of companies in the accession countries to compete in the Single market. This is particularly notable in the case of Lithuania where the national currency has been fixed to the US dollar which has been appreciating against euro after its introduction.

Third, as surveys of foreign investors indicate, the benefits of trade liberalization between the accession countries and the EU and the resulting competition have been already quite visible. Interestingly, some investors say that most benefits of economic integration have already been achieved.

So, one could conclude that competition, except in some protected sectors like agriculture, presents benefits rather than threats and some candidate countries are more open to competition than some members states. Therefore it is interesting to note that some EU member countries are increasingly concerned about "harmful competition" from some candidate countries.

2. The economic impact of adopting EU *acquis communautaire* regulating economic activities in the candidate countries seems to have been underestimated.

It seems that with progress in negotiations and corresponding need to provide estimates of investments necessary to meet EU rules and norms, there is a growing apprehension of the size of investments required in the candidate countries. We can quote different estimates and exact numbers but they are not so important here. What is important is the implications of these investments. First, they imply increasing need for financing the adoption of standards of products and production processes. This in turn means that some comparative advantages of businesses in accession countries are likely to be lost in the process of harmonization. As the most recent issue of *The Economist* claims, "By encouraging trade and investment, enlargement will certainly contribute to prosperity. But by obliging the applicant countries to adopt laws that may be inappropriate for them, it could also neutralize that potential benefit". Investment needs also imply higher budgetary expenses. Finally, while the regulatory costs are becoming quite noticeable (and this is probably one of the reasons of decreasing EU popularity in some accession countries), benefits will become apparent only in the longer-term and will depend to a large extent on policies of regulatory institutions.

It is interesting to note that with the progress in economic integration and adoption of the *acquis*, the technique called regulatory impact assessment has been increasingly applied in some countries. This is particularly the case in Lithuania, where the qualitative regulatory impact assessment has been conducted for some 2000 EU norms. The need for the RIA is justified by the need to better prepare the negotiating positions, to inform the population and also to understand better the impact of EU regulations. However, the RIA also has its limits and is sometimes overshadowed by political aspects of adopting EU norms.

3. There seems to be exaggerated expectations concerning the benefits of the EU funds for the candidate countries.

The most popular explanations of EU benefits focus on EU funds. It is understandable because it seems easier to sell this to population. For example, according to a recent study, the net balance of receipts from the EU budget to Lithuania (and this was considered to be a "realistic scenario") would constitute around 279 million euro, or 2 percent of the country's GDP. However, here one has to be aware of several important political and economic implications. First, there is a danger to create unreal expectations, which can be already observed in the case of long promised SAPARD program. Second, in many cases EU funds are likely to benefit concrete groups of population but with co-financing required this might result in higher budgetary needs. The co-financing together with Lithuania's payments to the EU budget would almost equal the receipts from the EU budget (the co-financing only would constitute around 238 million euro). Third, potential supply of funds is likely to mobilize interest groups and to create stronger incentives for corruption and distortion of investment incentives. The latter problem can be illustrated most clearly by dilemmas facing accession countries in the reform of agricultural sectors. One might ask what credible incentives farmers in the accession countries might have to restructure and increase their efficiency when the EU itself provides a role model of how to rely on support from state budget and protection from external competition.

4. The general economic impact of EU membership will to a large extent depend on the autonomy of state institutions to demands of interest groups.

This is an important aspect which has been noted in previous enlargements as well. Accession into the EU implies increased regulation of economic activities and most probably additional regulatory institutions. This, together with a potential increase in financial support from the EU, creates incentives and possibilities for the "regulatory capture" and "administrative corruption" in these countries. Therefore, transparency of the regulatory process, simple rules and clearly defined functions are very important. With the period of "extraordinary politics", to use the phrase of L. Balcerovitzs, gone in the past and institutionalisation of channels of interest representation, the ability to resist demands of interest groups is becoming more difficult. This is particularly important in the sectors that are still in the process of reform like agriculture or the energy sector.

5. What does exactly EU membership entail?

Here it is useful to remember two well-known methodological problems of any precise scientific efforts aimed at estimating the impact of EU membership. **First**, integration measures versus general reforms in the accession countries. Although some already claim that the transition process is over, reforms in the sectors such as agriculture or energy form part of both EU accession and creation of conditions for market economy (although it is more evident in the energy sector than in agriculture). So, we will be always facing this problem of separating what we are doing specifically for the sake of joining the EU. This is not only a methodological challenge but can also become a politically sensitive issue when populations in these countries have to be informed about benefits and costs of EU membership.

Second, there is also an old and well-known problem of the "moving target". Although the EU is rather conservative and slow to change, it is likely that its enlargement will eventually change the EU itself. We already know the proposals of the German government which include specific ideas on the division of competences between EU institutions, EU institutions and member states and devolving some policies, like agriculture or infrastructure, to the level of member states or regions. We also know the ongoing debates, for example, taxation policies in the EU, on the one hand, and deregulation of financial markets and energy markets, on the other. This means that in some five years the EU might look quite different from its current form. While this is clearly the topic for a separate discussion, it also means that eventually the impact of EU membership might involve some aspects which cannot be observed at the moment.