# RAISING EU PRE-ACCESSION COUNTRIES' COMPETITIVENESS

**Speech for the meeting at EANPC, 6 April 2000**

## 1. The pre-accession process

### 1.1. Meeting the Copenhagen criteria

In 1993, at the Copenhagen European Council, the Member States defined the criteria for accession to the EU for **candidate countries**. Membership requires that the candidate country has achieved:

1. stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
2. the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union;
3. the ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union (the so-called acquis communautaire).

CCs have also to create the conditions for integration through the adjustment of their administrative structures, so that European Community legislation transposed into national legislations is implemented effectively.

The last **regular reports**, published in October 1999 contain a detailed analysis of the progress made by the 13 candidate countries. They show that all countries except Turkey fulfil the political criteria for accession and that only Cyprus and Malta fully meet the economic criteria. Regarding the adoption of the acquis, the situation varies between countries: while good progress was made by Hungary, Latvia and Bulgaria the pace of transposition in Poland and the Czech Republic was slow.

I focus shortly on the **economic criteria**:

The 1999 assessment of the progress made in meeting the Copenhagen economic criteria took place against the background of a worldwide slowdown in growth in the aftermath of the Asian, Russian and Kosovo crises. Against this background, the average real GDP growth in 1998 for the ten central and eastern European countries was 2.2%. Hungary and Poland, at 5.1% and 4.8% respectively, maintained the highest growth rates.
The volume of foreign investment increased in 1998 despite greater investor caution about emerging markets in general. Inflation was lower than expected. With the exception of Estonia and the Czech Republic, all the candidate countries registered a widening of their trade and current account deficits in 1998 as a result of decline in external demand.

**The existence of a market economy and ability to cope with competitive pressure**

It finds that two of the candidates, Cyprus and Malta meet these criteria. Of the ten central and eastern European countries, Hungary and Poland come closest to meeting the criteria, followed by Slovenia and Estonia, and then the Czech Republic, which needs to make serious progress. Latvia has made significant progress in the past year and can now be added to this group. Slovakia has made important progress but needs to consolidate its reforms.

Lithuania's progress over the past year has not been as strong as could have been expected.

Bulgaria and Romania do not meet either economic criterion. Encouragingly, Bulgaria continues to make significant progress and shows sustained efforts in the economic reform process, but started from a very low level. Regrettably, the situation in Romania has, at best, characteristics of a functioning market economy but needs to continue to focus on achieving macroeconomic stability by reducing inflationary pressures, public deficits and by continuing structural reform.

At the end of 1999, at the Commission's suggestion, the European Council of Helsinki decided to **open negotiations** with Malta, Latvia, Lithuania, Slovakia and also with Bulgaria and Romania but subject to certain conditions for the latter two (nuclear safety / childcare institutions).

## 2. To enhance Candidate Countries' competitiveness

### 2.1. Enlargement Strategies for Industrial Policy

The EU's industrial policy priorities are: the promotion of intangible investment, the development of industrial co-operation, the strengthening of competition and the modernisation of the public authorities.

The opening up of the formerly closed economies of Central and Eastern Europe to global competition and their preparation for joining the EU creates competitive, legislative and institutional challenges for this industrial policy. In order to meet these challenges, EU industrial competitiveness policy would indicate that priority action is required in the area of industrial restructuring and the gradual extension of the EU internal market to the candidate countries.

I would like to focus now on the **competitive challenge**.

Competitiveness is the decisive criterion for the assessment of industrial restructuring activities in the prospective Member States.

In that context, most candidate countries have made substantial progress since the beginning of the 90s, but a large gap still needs to be bridged in order to reach EU competitiveness levels. GDP per capita, which is an important indicator for the economic success of a country, is still at less than 50% of the EU average. However, productivity has been growing considerably since 1994.

Improvement in the industrial competitiveness of the candidate countries will depend upon many complex factors. Foreign direct investment is playing a leading role in know-how transfer, technologies need to be updated, public infrastructures to be modernised and more emphasis put on quality programmes and on research and development.

## Priority Actions

### *1. Restructuring for industrial competitiveness*

While industrial restructuring in the present EU Member States has been a continuous process over a relatively long period, the Central and Eastern European countries, at the beginning of the 90s, were facing a situation where the whole economy had to suddenly undergo almost complete restructuring.

According to the World Bank, privatisation has been the "single most important determinant of success" in industrial restructuring in the nations of Central and Eastern Europe. It should be noted, however, that in certain industries the impact of restructuring will be painful, in particular when they are concentrated in industrial regions where they are the principal economic activity. Industrial restructuring and modernisation of these sectors will, therefore, have to be accompanied by regional and social measures to attenuate its impact on society and the economy.

### *2. Promoting investment*

Given the central role of investments in the restructuring process, the **promotion of investments** has become a priority for the CEECs. The self-financing of the modernisation of the production equipment and processes by existing industrial firms is one form of investment that can contribute to gaining better competitiveness on an enterprise level. In order to allow this to happen, companies must be given the opportunity to retain earnings for investment, meaning that taxes and social costs should be in proportion to the infrastructure provided for by the state.

**Greenfield investment** can have a very positive influence on the industrial tissue of the host country. An example of this phenomenon in the EU is the investment of foreign motor manufacturers in the UK, which resulted in a considerable improvement of the competitiveness of the UK automotive supplier sector. A similar process, after investments by EU auto manufacturers, is now underway in Poland, Hungary, the Czech Republic, Slovakia and Slovenia.

Investments by **SMEs** are equally important. Here it is often the availability of capital that is the prime precondition for the success of innovative, new enterprises. The role of the banking systems and the creation of functioning venture capital funds and markets in the candidate countries, therefore, deserves more attention.

Another important aspect is the promotion of **intangible investment**, notably research and development and professional training. While the emphasis in the industrial policy of further developed market economies lies on this investment aspect, for the CEECs, however, tangible investments still have priority.

It has to be ensured, however, that support of investments in the candidate countries is performed in compliance with EU **State aid rules** in order to avoid unjustified damage to disadvantaged regions in the EU. The Union and the candidate countries have a common interest in ensuring that companies relocate on the basis of a favourable business environment rather than because of the availability of public money and/or important tax privileges.

### *3. Developing industrial co-operation*

Industrial co-operation aims at creating long term strategic partnerships between economic operators based around the mutual interest of both sides. By actively identifying new possibilities and ensuring that potential partners are aware of them, public authorities can play an active role without intervening in the efficient allocation of resources by the market.

Concerning the countries of Central and Eastern Europe , the Commission has developed a specific strategy for the promotion of industrial co-operation. This strategy has three main principles:

- creation and promotion of networking between institutions providing business support services;
- encouragement of inter-industry dialogue between EU and CEECs (e.g. support to the organisation of meetings between industrialists of a sector in the framework of trade fairs);
- facilitation of legislative alignment through the organisation of seminars for industrialists on specific subjects such as the Community system for placing pharmaceuticals on the market.

Good examples for East-West industrial co-operation can be found in the textiles sector or in the shipbuilding sector. Since 1997, in the framework of the enhanced pre-accession strategy, industrial co-operation activities have been developed in the form of multi-annual co-operation programmes.

With regard to the promotion of the inter-industry dialogue, the national authorities and the representatives of industry (EU + candidate countries) have asked for the creation of an **Industrial Forum on Enlargement**. This is an industry-led activity that is being launched by the Commission, and notably by ENTR DG.

Financing for such multi-annual co-operation activities will be available under the PHARE **"Business Support Programme"**, which will be operational very soon.

### *4. Benchmarking*

Benchmarking is an instrument to assist enterprises, industries and public authorities improve their performance by monitoring progress against continuously improving worldwide best practice. This is becoming a key activity inside the EU after the recent

European Council in Lisbon. Our aim is to extend in the future some sort of benchmarking activity to the candidate countries.

### *5. Extending the Internal Market*

The accession of new Member States will underline the position of the EU as the world's most important market for industrial products and services. The extended Internal Market will create an improved business environment and better trade conditions which will further support the higher growth rates that are necessary to enable the CEECs to catch up with the present EU Member States.

The candidate countries will have to implement more than 200 directives concerning the placing of products on the market, as well as further directives on the free movement of services, capital and persons in order to fully comply with the acquis in this area on the day of accession to the Union.

The **Europe Agreements**, signed between the EU and each of the CCs, have provided the legal basis for the extension of the internal market. They are based on shared understanding and values, setting the path for progressive convergence in a wide range of fields. They include an important set of economic provisions including free trade in industrial goods and the liberalisation of services supplied across borders.

### *6. The legal transposition of the acquis (current situation and envisaged alignment) and Negotiating PECA - Protocols on European Conformity Assessment*

The necessary process of legislative approximation has already begun. The analytical examination of the *acquis* (screening) in this area has shown that there is a great willingness to implement the *acquis* and not to ask for transitional periods or derogations.

The screening of the free movement of goods has shown that there is a great willingness among candidate countries to amend their legislation accordingly before the date of accession. A number of countries have already enacted some of those framework laws, which is a positive development. Where technical standards within the EU are not harmonised, the free movement of goods needs to be ensured by applying the principle of mutual recognition and by the acceptance of the rule that national specifications should not be more stringent than is required to achieve their legitimate objectives.

Based on these principles, the EU aims at eliminating technical barriers to trade through the implementation of **"Protocols on European Conformity Assessment"** with the CCs. They are intended to give candidate countries sectoral access to the internal market even before accession. Once a candidate country has taken over EC legislation in one sector and the necessary structures for its implementation are in place, this sector can be included in the Protocol.

During the second half of 1997 negotiations were started with Hungary and the Czech

Republic, since the alignment of the legislation and the institutional framework has already progressed quite far in these countries. Negotiations and legal alignment are now being intensified. With Lithuania, Slovakia and Slovenia they are staring in these weeks.

### *7. Building the institutions*

A change only in the legislative system of the candidate countries is a necessary, but insufficient condition for a successful enlargement process. It is also important that the institutions required to operate the EUs regulatory system are operational.

While some progress has been achieved in the past, the separation between regulatory, standardisation and certification functions still has to be pursued further in most candidate countries. The necessary technical expertise also needs to be developed. In this context, the PRAQ III programme, that forms part of Phare, aims at the further development of the CEECs institutional framework and at ensuring that the newly created institutions are able to manage their own development in line with market needs.

## 2.2. Study on the competitiveness of industry in CEECs

The Enterprise DG is carrying out an internal study on the competitiveness of industry in CEECs, with the aim of increasing knowledge about industry and different industry sectors in the candidate countries and to get a coherent overall picture of the level of competitiveness.

The report provides a **general overview of the competitiveness of the 10 candidate countries of Central and Eastern Europe**, based on a set of 30 indicators. It also aims at providing an **analysis of the likely level of competitiveness of each of the industrial sectors in the applicant countries**. This should enable to identify, for each of the applicant countries, whether any part of their industry will have particular problems to cope with the competitive pressure of full EU-membership at the time of accession.

The first provisional results of the study show that here are some clear front-runners and some definite laggards. The clear front-runner is, as usual, Hungary, which scores highly on almost all indicators. Romania is also clearly lagging behind for most of the indicators. Bulgaria, which is often taken to be in a similar situation, seems to have made considerable progress since the introduction of the currency board. The differences between the five countries with below average performance (but ahead of Romania) are relatively minor, but then there is a considerable jump between Slovenia and Poland (which practically ties with the Czech Republic).

The following industries were considered significant and selected for closer analysis: CHEMICAL INDUSTRY, MECHANICAL ENGINEERING, ELECTRICAL ENGINEERING, MANUFACTURE OF MOTOR VEHICLES AND ACCESSORIES, TIMBER AND WOODEN FURNITURE and FOOTWEAR AND CLOTHING.

The main results were:

1. Motor vehicles and accessories is by far the most competitive industry. This suggests that the automobile industry in the candidate countries should have no problem competing on the internal market. However, this industry might be special since it is dominated by firms from the EU.

2. At the other end of the range there are three industries that stand out because they show little competitiveness and which might thus merit closer attention as they might have more difficulties in competing on the internal market: the chemical industry, mechanical engineering, and instrument engineering. These three are generally characterised by a high capital intensity. The chemical industry is intensive in both human and physical capital. A lack of physical capital can be remedied through high rates of investment, in countries with high savings and investment rates industries intensive in physical capital might thus gain some competitiveness relatively quickly. But a lack of human capital takes more time to correct; problems in the chemical industry might thus be more persistent.

3. Somewhat to our surprise our analysis did not suggest competitiveness problems in such high tech sectors as office and data processing or electrical engineering. The puzzling result for office and data processing is in line with other studies which have also noted that this fast moving sector does not conform to standard patterns.

## 3. Instruments of the Pre-accession strategy and types of support

### 3.1. Instruments of the pre-accession strategy

Given the intensification of the enlargement process during 1996 and 1997, it has been necessary to reinforce the pre-accession strategy.

The negotiating process for accession is based on the **Europe Agreement** that every CC signed with the EU. It provides the framework for bilateral relations between the European Communities and their Member States on the one hand and the partner countries on the other.

The Europe Agreements cover not only trade-related issues, but also political dialogue, legal approximation and other areas of co-operation, including industry, environment, transport and customs. They aim progressively to establish a free-trade area between the EU and the associated countries over a given period, on the basis of reciprocity but applied in an asymmetric manner (i.e. more rapid liberalisation on the EU side than on the side of the associated countries).

The Europe Agreements are implemented by several tools:

- Bilateral meetings at ministerial level between the European Union and an associated country (**Association Councils**);

- Meetings at senior official level (**Association Committees**), complemented by a series of sub-committees, which provide for regular in-depth technical discussions on all areas covered by the Agreement.
- **Joint Parliamentary Committees**. These bring together members of the national parliaments of the associated countries and members of the European Parliament.

On the other hand, the pre-accession strategy has two main objectives:

1. to bring together all the different forms of support within a single framework, called an **Accession Partnership**, for each country, and to work together with the candidates, within this framework, on the basis of a clearly defined programme
2. to prepare for membership to familiarise the candidate countries with EU policies and procedures through their increased participation in Community programmes.

**Accession Partnerships** (APs) are the key feature of the reinforced pre-accession Strategy. It contains the guidelines for pre-accession aid (the Phare Programme, agricultural support, structural support and participation in Community programmes).

Each country's Accession Partnership is complemented by its own **National Programme for the Adoption of the *Acquis*** (NPAA). For its part, the NPAA gives details of each country's commitments with regard to achieving the Copenhagen criteria and adopting the 'acquis communautaire'.

**3.2. The Phare Programme**

**Phare** is identified in the Europe Agreements as the financial instrument specifically aimed at helping achieve the objectives of the Europe Agreements.

**Phare** is currently the main channel for the European Union's financial and technical co-operation with the countries of central and eastern Europe (CEECs). Set up in 1989 to support economic and political transition, Phare had by 1996 been extended to include 13 partner countries from the region. Originally allocated € 4.2 billion for the 1990-1994 period, the Phare budget was increased to € 6.693 billion for the 1995-1999 period.

In Agenda 2000, the European Commission proposed to focus the Phare Programme on preparing the candidate countries for EU membership by concentrating its support on two crucial priorities in the adoption of the *acquis communautaire*: **Institution building** and **investment support**.

**Institution building** means adapting and strengthening democratic institutions, public administration and organisations that have a responsibility in implementing and enforcing Community legislation. The integration process is not simply a question of approximating candidate countries' legislation to that of the Community; it is also one of ensuring the effective and efficient implementation of the texts. It includes the development of relevant structures, human resources and management skills.

It also means training and equipping a wide range of civil servants, public officials, professionals and relevant private sector actors: from judges and financial controllers to environmental inspectors and statisticians, to name but a few. Approximately 30 per cent of Phare funds will be used to meet these institutions building needs, in accordance with the conclusions of the Luxembourg European Council, in particular through the **twinning** mechanism.

**Twinning** was launched in May 1998. It provides the framework for administrations and semi-public organisations in the candidate countries to work with their counterparts in Member States to develop and implement a project that involves the transposition, enforcement and implementation of a specific part of the *acquis communautaire*. The main feature of a twinning is that it sets out to deliver specific and guaranteed results. It is not designed to foster general co-operation but to deliver specific results agreed between the parties in advance for the implementation of priority areas of the acquis, as set out in the Accession Partnerships. Instead of having recourse to short-term, problem-solving expertise, twinning involves the long-term secondment of EU experts to the candidate countries to effect longer-term change.

The second PHARE priority is to help the candidate countries bring their industries and major infrastructure up to Community standards by mobilising the **investment** required. This effort will be largely devoted to areas where Community norms are becoming increasingly demanding: environment, transport, industrial plant, quality standards in products, working conditions, and so on. This priority is granted with 70% of the PHARE budget.

Investment support thus falls into four main categories:

- investment in EU norms: support for the alignment of norms and standards with those of the EU
- regional development: support for the development of regional, social and rural policies similar to those developed in the EU;
- large-scale infrastructure, particularly in transport and the environment;
- SME support: support for the development of SMEs in the candidate countries, particularly by contributing to a multi-beneficiary fund for SME financing.

Phare amounts to € 1.5 billion per year. The other pre-accession support elements are, from the year 2000: aid for agricultural development (SAPARD), that will amount to € 500 million per year, while structural aid (ISPA) will total € 1 billion per year. The structural aid will be directed mainly towards aligning the candidate countries with Community infrastructure standards, particularly in transport and environment. It will also help familiarise the candidate countries with the arrangements for implementing structural measures.

*The **SME sector** has the potential to contribute a great deal to the accession process, by generating wealth and employment, and by introducing greater market flexibility into the economies of the candidate countries. However, financing for SMEs is still limited in the candidate countries and SMEs find it hard to obtain credit. Given that support for SMEs is needed, to varying degrees, throughout the region, a horizontal SME Facility is* *set up to provide support to all the candidate countries. The SME Facility operates on the basis of co-financing with the EIB, the EBRD, commercial sources, and financial institutions in the EU and the candidate countries.*

*The aim of the SME Facility is to provide equity, loans and guarantees to SMEs based in all ten candidate countries through existing local financial intermediaries. In this way, Phare will help develop and strengthen SMEs and encourage the growth of the sector. Support will also be provided to help meet the cost of adapting existing SMEs to meet EU norms and standards.*

**4. The Multiannual programme for Enterprise and Entrepreneurship**

Now I turn up to an initiative of the Enterprise DG. The current 3rd Multiannual Programme for SMEs, that covers the period 1997-2000, covers a wide range of action. It addresses the needs of maintaining quality and excellence, forging strategic partnerships and financing ventures, as well as the challenges of adjusting to operating in a knowledge-based, service-oriented economy. The Commission has also worked to provide SMEs and entrepreneurs with the information they require to do their business.

The challenge now is for Community SME policy to build on the positive achievements of the past and present, while at the same time anticipating the demands of the future. This is not a simple task in a rapidly changing business culture. It requires an appraisal of the function of the public authority in helping to provide solutions and anticipate demands thrown up by the functioning of the market.

The Commission will produce a proposal for a **new 5 year Multiannual Programme for Enterprise and Entrepreneurship within the next few weeks**. The programme will operate in up to 31 countries, covering the European Economic Area and the candidate countries for European Union membership. **The specific emphasis will be on the requirements of SMEs**. The new programme will concentrate on action in a small number of priority areas. These are:

1. the promotion of entrepreneurship as a valuable and productive life skill
2. the further development of a regulatory and business environment in which enterprise and entrepreneurship can flourish
3. ensuring the provision of business support networks and services
4. improved access to finance
5. enhanced competitiveness in the knowledge-based economy.

In short, the Commission wants to engender an increased spirit of entrepreneurship; to encourage more people to consider setting up their own business; to develop a business and regulatory environment that allows them to do so successfully; to help provide them with the means to compete, adapt, innovate and grow.

The opening up of community programmes plays a key role in the pre-accession period. It provides the accession candidates with the opportunity to become familiar with community policies and instruments. The basic idea is to integrate the candidates into European activities as well as to familiarise them with our priorities and our working methods. Candidate countries' organisations and institutions are invited to participate in actions developed under the Multiannual Programme, but we have not invented specific actions that have no equivalent for the EU Member States.

The Third Multiannual Programme for SMEs has until now been opened up to nine CEECs. The Association Council Decisions regarding the participation of **Bulgaria**, the **Czech Republic**, **Estonia**, **Hungary**, **Poland**, **Slovakia**, and **Romania** in the Third Multiannual Programme were adopted at the end of 1998 and entered into force in December 1998/January 1999. The Association Council Decision regarding the participation of **Slovenia** came into force on 1 October 1999 and the Decision for **Lithuania** came into force on 1 March 2000. During this year, we should normally also be able to welcome **Cyprus** and **Latvia** into the programme.

The candidate countries pay annually a contribution (partly from their national budget and partly from their national Phare allocation) for participation in the areas of the programme that they have chosen themselves. The areas chosen were as follows:

- Support for **Euro Info Centres**: upgrading of the existing Correspondence Centres and the selection of new EICs.
- Participation in **Europartenariat** events.
- Support for one **INTERPRISE** event per year in each country (all countries).
- Support for one **IBEX** (subcontracting) event in the whole region (Only Hungary, Poland, Slovakia, Latvia, and Slovenia will participate).
- Actions within the field of **Crafts and Small Enterprises** (all countries except Romania)
- Actions within the field of **Distributive Trades** (all countries except Romania and Slovakia).