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**Progress report on the pre-accession strategy with the
associated countries of central and eastern Europe**

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The Essen European Council asked the Commission to report annually on progress with the pre-accession strategy and, in particular, on alignment with the internal market. The Cannes European Council, stressing the importance it attached to preparing the accession of the associated countries, invited the Commission to report on progress in implementing the White Paper.

The present report provides the European Council with an overall view of the state of development of the pre-accession strategy and of the political and economic situation in the associated countries in central and eastern Europe. It is to be read in conjunction with the other studies and analyses requested at Essen.

The pre-accession strategy

The pre-accession strategy encompasses many actions in a wide range of sectors with a view to facilitating the enlargement process.

The main instruments of the strategy are the Europe agreements, the structured relationship with the institutions of the Union, Phare and the programme for alignment with the internal market as set out in the Commission's White Paper. The situation with respect to each of these elements, as well as other aspects of the pre-accession strategy, is presented briefly in the following paragraphs.

The Europe agreements

The Europe agreements are the foundation for the pre-accession strategy. These agreements are strengthening the links between the Union and each of the associated countries. In addition to the six agreements already in force, agreements were signed in 1995 with Estonia, Latvia and Lithuania and an agreement was initialled with Slovenia.

The negotiations for adjusting the Europe agreements to take account of the recent enlargement of the Union and the Uruguay Round are continuing in the agricultural sector. Meanwhile autonomous measures have been applied to allow traditional trade flows to continue. Negotiations should be completed as soon as possible on further measures to stimulate agricultural trade between the Union and the associated countries.

The structured relationship

The structured relationship between the associated countries and the institutions of the Union encourages mutual trust and provides a framework for addressing topics of common interest. Meetings have been held in 1995 according to the programme in the Essen conclusions in such areas as foreign affairs, the internal market, justice, economics and finance, as well as culture, research, agriculture, transport, and education. Besides the annual or biannual meetings which were planned in advance, additional meetings were held at the level of heads of state and government and between ministers responsible for the internal market, economics and finance.

This has provided opportunities for the ministers from the associated countries to become acquainted with the Union's internal mechanisms and for representatives of the Union better to understand the preoccupations of their counterparts. In the CFSP, joint declarations and demarches have resulted from this structured cooperation.

But, given the novelty of this process and the practical complications inherent in the organisation of meetings with so many participants, there is room for improvement in the way the structured dialogue is prepared and implemented.

Phare

As the main financial instrument of the pre-accession strategy, Phare has been adapted to the needs and priorities of each beneficiary country. It has evolved from an initial focus on technical and humanitarian assistance to new priorities related to preparation for membership. It supports privatisation, investment, the improvement of infrastructure as well as alignment with the internal market, enterprise creation, connection with trans-European networks and strengthening civil society and democracy.

To prepare for accession, modifications have been made in 1995 to the programming procedure. In agreement with the associated countries, indicative multi-annual programmes have been introduced. This will allow Phare to make

a more coherent contribution to the medium term process of adjustment and should facilitate the disbursement of assistance. To multiply its impact, especially on restructuring, Phare is also making larger amounts available for co-financing with financial institutions, such as the EBRD.

Integration into the internal market

The preparation of the associated countries for their integration into the internal market is proceeding pursuant to the White Paper tabled at Cannes, which builds on the work on the approximation of legislation undertaken in the relevant sub-committees of the Europe agreements. A new Phare multi-country programme supporting alignment with the internal market was approved at the end of September. In close consultation with the Member States, the Commission is establishing a pool of experts to make the best professional advice in the Union available to the associated countries.

In all the associated countries, the governments have set up special structures to coordinate the integration process and consultations are taking place in the relevant sub-committees of the Europe agreements. National programmes for the approximation of legislation are being adjusted in the light of the White Paper recommendations.

The task is now well under way but its size and complexity make coordination and monitoring a constant necessity. Success also depends on support from the Member States. The Technical Assistance Information Office will offer its services to the associated countries from the beginning of 1996.

Agriculture

In the field of agriculture, the Commission is presenting its study on alternative strategies for the development of relations in this sector between the EU and the associated countries with a view to their future accession.

This study was prepared on the basis of data on the agricultural situation in ten central and east European countries. Following discussions with the countries concerned, in particular in the framework of the structured dialogue, the Commission has identified the main challenges for the future of agriculture in Europe. This study also touches on the question of subsidised exports to the associated countries.

The Commission is continuing its examination of the effects of such exports on agriculture in central and eastern Europe. The results of this examination will be transmitted to the Council when completed.

In the context of the adjustment of Europe agreements for the Union's recent enlargement and the Uruguay Round, a report on the reasons why few tariff quotas opened by the Union are fully utilised was tabled in June 1995. Ways to improve the use of existing quotas are under further consideration.

Cooperation in other fields

Cooperation in many fields has been enhanced as part of the pre-accession strategy. Investment promotion is a particular priority in view of the need to modernize and restructure the economies of the associated countries. Work programmes have been undertaken in sectors such as the environment, energy, business cooperation, the trans-European networks, education, training as well as competition policy and state aid controls on which a separate report is under preparation.

Regional cooperation and good neighbourly relations

The Union attaches great importance to regional cooperation and good neighbourly relations which are being promoted through a number of programmes. Phare has been providing support for regional cooperation since 1990 and a new regional trade development programme was approved in July 1995. Further programmes for cross-border cooperation will be set up. The Union strongly supports the Central European Free Trade Area and its extension to additional countries in the region.

Trade

In the trade field, the Commission is preparing proposals to extend the cumulation of rules of origin and to harmonise them in the different agreements between the Community, the associated countries and the EFTA countries, pursuant to the Essen conclusions. This will favour trade and industrial cooperation among all countries concerned. The associated countries will need to conclude and implement agreements among themselves to allow this goal to be achieved.

The political and economic situation in the associated countries

Political situation

The constitutional changes which were adopted between 1989 and 1992 in most central and east European countries are designed to guarantee democracy and the rule of law. In general, democratic institutions are functioning well, elections are free, and constitutional provisions are observed. Human rights are, on the whole respected. But the situation concerning the protection of minorities, respect for constitutional checks and balances, and the independence of the media and of non-governmental organisations gives concern in some cases where further progress is needed to ensure political stability.

Economic developments

In 1994, all associated countries recorded positive economic growth. The recovery started in 1992 and has since spread over most of central and eastern Europe. In 1994, growth ranged from less than 2% in Latvia, Bulgaria and Lithuania to 5% and above in Slovakia and Poland. In 1995 economic growth should be at least at the same level as last year in most countries, but it is likely to be lower in Hungary and Latvia. Nonetheless, with the exception of Poland, output has not yet increased enough to offset the contraction in the early years of the transition process.

In general, the recovery has been export led. Due to the economic upswing in western Europe, and the competitive prices and increased quality of products in the associated countries, exports to the EU grew rapidly. Trade among the associated countries also rose substantially, an evolution that should continue. *But* in some countries imports rose in response to faster growth, and the CE-10 as a whole have a trade deficit with the Union. But improved export performance led to lower trade deficits in most countries in 1994. Current accounts are expected to deteriorate in 1995, but within the limits of the financing capacities of the countries.

Growth is increasingly dependent on investment, rather than exports, in countries where reform is most advanced. But flows of foreign investment are insufficient by comparison with the needs for economic reconstruction and still encounter administrative and fiscal obstacles in some countries. Recovery also permits improvements in real wages, which supports private consumption. Overall the role of domestic demand in the recovery process is becoming more important.

Unemployment soared in most associated countries at the beginning of the transition process. Recovery is now producing a modest decline in unemployment.

Inflation has been reduced in all countries through tighter monetary and fiscal policies. The Czech and Slovak Republics recently reached single digit inflation rates. However, in the other associated countries inflation is still considerably higher, with an expected inflation rate of between 23% for Latvia and 60% for Bulgaria in 1995.

Fiscal and monetary policies continued to be relatively tight in most countries. With the exception of Romania, Latvia and Lithuania, budget deficits were further reduced in all countries in 1994; Estonia and the Czech Republic even recorded a surplus.

The private sector now accounts for more than half of GDP except in Bulgaria and Romania. Nevertheless, further privatisation is generally proving difficult, particularly in sectors such as banking and those dominated by large state-owned enterprises.

Where private sector progress is least satisfactory, this is mainly owing to delays in the implementation of privatization strategies and enterprise restructuring. Privatisation should be pursued in a transparent and objective manner. The legal and institutional framework for a market economy also needs to be completed in several countries to create a more favourable business environment.

Orientations for 1996

The pre-accession strategy has already begun to bring results. It has confirmed the Union's commitment to creating the conditions for the success of further enlargement, it has reinforced the political and economic reform process, and strengthened links in many fields between the Union and the associated countries. Nonetheless there is scope for improvement both in the actions taken by the associated countries themselves and in our joint efforts.

Strengthening the reform process

The Copenhagen European Council set out the broad conditions for Union membership. On the whole, considerable progress has been made towards satisfying these conditions. But the situation varies considerably from country to country and needs to be followed closely.

The democratic process has taken root firmly in all associated countries. But institutional and legal reforms need to be pursued vigorously and particular attention given to the respect for minorities and to the independence of the media. Progress is also needed in certain countries to ensure political stability.

On economic policy, macro-economic stability is a basic requirement which calls for further efforts in some countries. Privatisation and economic restructuring need to be pursued under transparent and objective conditions. The business environment should be made more attractive by liberalising trade, particularly trade among the associated countries, by making real progress towards achieving the Central European Free Trade Area, and by simplifying regulations and taxation which affect investment.

Further efforts are also needed in bringing sectoral policies into line with those in the Union, for example, in the fields of competition, environment, nuclear safety, transport, regional, consumer and social policy.

Developing the pre-accession strategy

As a result of the process set in motion by the Essen European Council, the Union's next enlargement will be the best prepared to date. The pre-accession strategy is laying the political and economic foundations for membership. Nonetheless, experience during 1995 suggests that there is room for improvement.

The structured relationship with the institutions of the Union has begun well, with an intensive programme of meetings. This is familiarising the associated countries with the functioning of the Union's institutions and providing a regular opportunity to discuss issues of common concern.

The relationship could be made more fruitful, however, if the meetings focused on more concrete issues and if they were better prepared at working level. Discussions of general subjects should be avoided and agendas should include issues arising in the pre-accession strategy itself and, where appropriate, items which are on the agenda of the corresponding Council meeting. The Commission is ready to contribute to preparations for such meetings by consulting with the associated countries and preparing a document which could serve to focus discussions.

Phare has become the principal financial instrument which supports preparations for membership and is developing along the lines agreed at the Essen and Cannes European Councils. Further emphasis needs to be placed on support for

investment and infrastructure and Phare will be supporting a number of projects in the area of justice and home affairs. Procedures need to be improved to achieve more efficient implementation.

Governments in the associated countries have made considerable efforts to coordinate more closely the bodies responsible within their own administrations for the implementation of assistance. In future, the associated countries themselves will be taking on more responsibility for the efficiency and rapidity with which programmes supported by Phare are implemented.

The programme outlined in the White Paper on the internal market is now being implemented. It will receive a major boost when the Technical Assistance Information Office will begin its activities in January. The Office will facilitate coordination between the Commission and the Member States, whose experts will be making an important contribution to the provision of assistance.

The Commission and Member States should work together through the pool of experts, with the support of the new Phare multi-country programme, to train officials in the associated countries in the implementation and enforcement of legislation. Meanwhile each associated country will need to complete work on its national strategy and its priorities for implementing the programme outlined in the White Paper.

To further develop trade, the Commission seeks to complete negotiations rapidly on the cumulation of rules of origin. The report on alternative agricultural strategies sets out the policies which the associated countries could pursue as well as indications on how the CAP could itself develop. The Union needs to make further efforts to improve market access in the agricultural sector. There should be an improved uptake in 1996 of existing quotas as well as the increased quotas which have been agreed.

Conclusion

The Commission considers the pre-accession strategy of crucial importance in preparing the associated countries for membership and is one of the Union's top priorities. Its success will contribute to the fulfilment by the associated countries of the criteria for accession. To ensure success, the process needs to be strengthened and kept under constant review. Accordingly, the Commission will continue to report to the Council on a regular basis.