ГОСУДАРСТВЕННЫЙ УНИВЕРСИТЕТ
ВЫСШАЯ ШКОЛА ЭКОНОМИКИ

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DOES ACCESION PROCESS OVERLAP WITH TRANSITION PROCESS: THE ROLE OF THE ACQUIS COMMUNAUTAIRE IN THE INSTITUTIONAL DEVELOPMENT OF TRANSITION COUNTRIES

Препринт WP2/2005/01
Серия WP2
Количественный анализ в экономике

Москва
ГУ ВШЭ
2005

УДК 330.341.2
ББК 65.5
В 11

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В 11 Does Accession Process Overlap with Transition Process: the Role of the Acquis Communautaire in the Institutional Development of Transition Countries: Working paper WP2/2005/01. – Moscow: State University – Higher School of Economics, 2005. – 24 p. (in English).

Institutional development tends to converge to several equilibriums differentiating by the level of development. Institutions external to a country, can help this country to find a "right" equilibrium. CEECs countries on average have institutional performance and economic development below the EU15 average. By choosing the *Acquis Communautaire* as external anchor CEECs may further improve their institutional development and, by consequence, economic performance. However, the adoption of the *Acquis* is costly, and some rules established by developed economies can downward competitiveness of the candidate countries. The present paper analyses the *Acquis* as potential institutional anchor for transition economies and discusses some costs of their adoption.

JEL Classification: P2.

УДК 330.341.2
ББК 65.5

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Сходства и отличия процесса расширения ЕС и переходного процесса: Роль Общеевропейского законодательства (*Acquis Communautaire*) в институциональном развитии стран с переходной экономикой: Препринт WP2/2005/01. — М: ГУ ВШЭ, 2005. – 24 с.

В зависимости от уровня экономического развития страны, ее институциональная среда будет стремиться к определенному равновесному состоянию. Принятие существующей модели иностранных институтов может помочь стране достичь "лучшего" равновесия. Институциональное развитие стран ЦВЕ в среднем ниже, чем в ЕС15, поэтому Общеевропейское законодательство может рассматриваться как внешний якорь для улучшения институционального и экономического развития. В то же время, принятие норм, установленных развитыми странами, имеет определенные издержки, в частности, снижение конкурентоспособности стран-кандидатов в ЕС. В настоящей работе Общеевропейское законодательство рассматривается как потенциальный институциональный якорь для стран с переходной экономикой, а также обсуждаются недостатки данной стратегии.

Классификация JEL: P2.

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1. Introduction: The role of external institutional anchor for development

Rich countries have generally well-functioning and market supporting institutions. Poor countries are "governed" by institutions ineffective for supporting neither market economy nor economic growth. The institutional development could promote market reform and economic growth in these poor countries. However, the poorer a country is, and less institutions are market-oriented, more difficult is to ameliorate the institutional performance in a given country.[1] Roland and Verdier (2003), analyzing Chinese transition process and accession to the European Union (EU), conclude that in presence of coordination problems in law enforcement, there is a possibility of multiple equilibrium. Institutional mechanism such as EU accession helps to eliminate a "bad equilibrium". Furthermore, institutional development represents a snow ball effect. Moving in a wrong sense, such institutions enforce impediments for economic development and emergence of market institutions. Institutions of another country or of a group of countries help to break up this vicious circle.[2] Usually, a small economy tends to adopt institutions of its bigger and more powerful neighbor. These foreign institutions (further, we will call them "external institutions") can not change or be influenced by domestic country. This does not mean that big and powerful country provides better institutional environment. Soviet Union had a large impact on COMECON[3] countries, including their institutional development. Being centrally planned economies, CEECs[4] were closed and self sufficient to be able to provide themselves by goods and natural resources. More country is open, more external institutions may have impact on domestic institutions, there is a higher probability that the country in question opts on market institutions. Notice, however, that political climate in this country plays an important role in this choice. Brezis and Verdier (2003) show that strong institutions in one country may influence positively institutions of its neighbor. According to Brezis and Verdier (2003), the presence of such strong institutional anchor as EU for CEE countries can explain why these countries have better functioning law enforcement mechanism than Russia. As noted by Winters (1995), international agreements also help to lock domestic policy in the "right" way. This is important for both: trade

[1] See Rodrik (2004).

[2] Institutions can also change rapidly due to economic or political crises, e.g., a revolution or a *coup d'Etat*. This institutional change may contain a potential danger of destabilization and depends on the direction of changes in political events and macroeconomic situation.

[3] The Council for Mutual Economic Assistance. All Central and Eastern European countries, except Slovenia, were members of this block.

[4] Central and Eastern European countries: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.

law and trade institutions. Note, that Berkowitz et al. (2003) show that not only institutions contribute to the economic development but first of all the process of their transplantation and adoption. Societies which adopted external institutions or who familiar with its rules have more effective legal institutions.

A country may found such an anchor voluntary or to be constraint to opt for market reforms for integration into the world economy. External anchor can accelerate the process of institutional reform, and support a deeper integration of this country into the world economy. However, the adoption of "foreign institutions" contains a potential danger. There is no institutional model that can be just simply transposed from one economic system to another. Historical and cultural conditions play an important role in institutional development and in the implementation of the "foreign" institutions.[5] From this point of view, the case of transition economies is quite interesting. These former socialist countries have different initial conditions[6] that influence the reform's success in these countries. The reform process itself is quite differentiated from one country to another.

What could be the potential anchor for the institutional reforms in transition economies? The importance of institutional anchors is mentioned in the IMF Economic Outlook 2003. However, the authors consider as institutional anchors international agreements rather then external institutions. As argued by the EBRD Transition Report 2003, for the new European Union (EU) members and candidates for future enlargement it could be the *Acquis communautaire*.[7] Countries of the South-Eastern Europe could improve their institutional environment by participating in Stabilization and Association Agreement, however *de facto* it plays much moderate role. For non-WTO members, and for Russia, in particular, such an anchor could be future participation in the WTO.[8] In Babetskaia-Kukharchuk and Maurel (2004) we discuss the advantages for institutional development and further economic integration from the Russia's accession to the WTO. The current paper is concentrated on the role of the *Acquis communautaire*.

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[5] Fidrmuc and Fidrmuc (2003) show that history has more important impact on trade than formal liberalization. De Ménil and Maurel (1994) show a link between history and trade. Acemoglu Johnson and Robinson (2001) emphasize that current institutional development is determined by former institutions existed two hundreds years ago.

[6] For the role of initial conditions see De Melo et al. (1996), Falcetti et al. (2000) and Fischer and Sahay (2004).

[7] The *Acquis Communautaire* or Community Law is the legislation of the European Union. Each country willing to join the EU must adopt the *Acquis Communautaire*. For more details about the *Acquis Communautaire* see the first section and Annex of this paper.

[8] The process of negotiation and participation in WTO can be more helpful for improvement of institutional environment for Russia than other CIS countries. Since Russia has significant political and economic power, a negotiation process is more strict than with small countries. A good example is Kyrgyz Republic. Having governance indicators worse than Russia, this country was one of the first from the former Soviet Union (FSU) countries who has joined the WTO.

The *Acquis* supports institutional development and market reforms in countries willing to apply for the EU membership. However, in the case of the last enlargement, the western-made legislation has been adopted by the former socialist eastern and central European economies. Prior to became EU members, most of them successfully achieved a long transformation process started in the last decade of the XXth century. However, historical, political, and economic development is different in west and in east of Europe. Certain norms and standards required by developed European economies, may bring more damage than benefits for transition economies. Piazolo (2000) gives a quite optimistic view of the EU enlargement and concludes that transition and accession process overlap with each other. In the current paper we give a more critical analysis of the *Acquis communautaire* as one of the main components of the accession process. We discuss potential gains and losses from such external anchor and try to support our analysis with available indicators.

The reminder of the paper is the following. The first section briefly describes the specifity of the current enlargement and the *Acquis* as an institutional anchor for the CEECs. Next section analyses how the *Aquis* can restraint competitiveness of the new EU members. In the third section we illustrate a positive impact on trade and economic growth from the institutional convergence in the CEECs toward EU standards. We argue that such institutional convergence can be reached through adoption of the Acquis Communautaire, and hence, the Acquis adoption represents potential benefits for economic development in CEECs.

2. Aquis Communautaire as an external anchor

From March 1994 to June 1996, ten CEECs officially presented a demand for accession. Negotiations with these countries was opened from 1998 to 2000 (see table 1). Current enlargement was very quick: the negotiation process for the eight of them was closed in December 2002, and in May 2004 these countries joined the European Union.

Table 1. *Enlargement process in the CEEC*

Country	Application	Opinion of Commission	Opening of Negotiations	End of Negotiations	Accession
Bulgaria	14.12.1995	13.10.1999	15.02.2000	26 ch. closed	*~ 2007*
Czech Republic	17.01.1996	16.07.1997	30.03.1998	13.12.2002	01.05.2004
Estonia	24.11.1995	16.07.1997	30.03.1998	13.12.2002	01.05.2004
Hungary	31.03.1994	16.07.1997	30.03.1998	13.12.2002	01.05.2004

Continue table 1

Country	Application	Opinion of Commission	Opening of Negotiations	End of Negotiations	Accession
Latvia	13.10.1995	13.10.1999	15.02.2000	13.12.2002	01.05.2004
Lithuania	08.12.1995	13.10.1999	15.02.2000	13.12.2002	01.05.2004
Poland	05.04.1994	16.07.1997	30.03.1998	13.12.2002	01.05.2004
Romania	22.06.1995	13.10.1999	15.02.2000	22 ch. closed	*~ 2007*
Slovakia	22.06.1995	13.10.1999	15.02.2000	13.12.2002	01.05.2004
Slovenia	10.06.1996	16.07.1997	30.03.1998	13.12.2002	01.05.2004

Source: Piazolo (2000), own additions using Enlargement of the European Union (2003). The number of Chapters closed for Bulgaria and Romania as of December 2003 (see the EU web site http://www.europa.eu.int).

The uniqueness of the current enlargement is not only in the acceptance at once of ten new members. The biggest EU enlargement is not so big as it seems to be. In terms of population, current enlargement is even smaller than the enlargement in 1973 on Britain, Denmark and Ireland, and in terms of land area it is smaller than enlargement in 1995 on Austria, Finland and Sweden. Current enlargement is comparable with whose on Spain and Portugal in 1986. The increase in population was 16%, and current enlargement increases EU population by 20%. GDP per capita in PPP of Spain and Portugal was 70% of EU members, while ten new member-states have GDP in PPP per capita on average about 40% of the EU level.[9] The most surprising is that for the first time in the history EU enlargement covers ex-central planed economies which are constrained to adopt, within a short period, institutions and legislation developed by the western European countries during the last forty years. As noted by Martens (2000), this is an "unprecedented experiment in institutional reform" because the process of the institutional transformation is not "home grown" but transposed from the western, EU, economies.

To became the EU member, each candidate-country should conform to the Copenhagen criteria which are divided into economic, political[10] and the *Acquis*.

[9] See Kok (2003). P. 33–34.

[10] The first two criteria aim to guarantee political stability, democracy, the rule of law, human rights and the respect for and protection of minorities, as well as macroeconomic stabilization. Candidate country should ensure the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union. In empirical studies, the Copenhagen criteria are used as a possible quantitative measure for the EU accession, e.g., Ricœur-Nicolaï et al (1999) apply factor component analysis to test the Copenhagen Criteria. Authors take the EBRD transition indicators as institutional proxies. They distinguishes two groups of CEECs, those more advanced and likely to join EU first, and less advanced economies.

Accession country must accept them, while the EU membership is not guaranteed.[11] From this point Copenhagen Criteria, including the *Acquis*, are external to the economies and can be considered as external anchor since a candidate country cannot modify them or accept them partially. However, these criteria are not entirely exogenous since to be able to implement them a candidate country should achieve a certain level of economic development.

The *Acquis* represents a Community Law founded in particular on the Treaty of Rome, the Single European Act, the Treaty of European Union (Jørgensen, 1999, p. 3). It is composed from the treaties, regulations, recommendations and directives passed by the European institutions and judgments of the Court of Justice. The aim of the Community Law is to approach the new EU-members' legislation to the European Union ones. This requires transformation of national institutions to conform with EU legislation, standards and rules. At the same time, they must set up or change the necessary administrative or judicial bodies which administer the legislation. All *Acquis*, with few exceptions, must be adopted or implemented before the accession to the EU. Candidate countries must harmonize national legislation to be in line with *Acquis*. In some cases a transition period is allowed.

The *Acquis communautaire* was created firstly by six EU members.[12] Since that the *Aquis* was largely developed. In present they account around 90,000 pages (Martens, 2000) and consists of 31 chapters. It aims to ensure freedom in movements of goods and capitals, freedom to provide banking, insurance and investment services, as well as freedom in labor force movement and recognition of professional qualifications within the Single Market. It harmonizes labor law and social security system. The *Acquis* regulates competition and industrial policy, company law and enterprise policy, protection of the industrial and intellectual property rights, transport and telecommunications. It establishes standards for agricultural products, control fishery sector and control environmental quality protection. The *Acquis Communautaire* protects consumer interests. the *Acquis* supports and harmonizes education, science and research. Custom Union, Schengen area and Economic and Monetary Union are also covered by the *Acquis*.[13] The *Acquis* has a strong impact on the institutional development of the new EU countries. Agricultural sector in the accession countries is much larger than in the EU one. On the contrary, service sector of accession countries is less developed than in EU. That is why the Agricultural Chapter (Chapter 7) is the largest Chapter in the *Acquis*. According to Piazolo (2000) the *Acquis* helps to the institutional building in the transitional

[11] Bulgaria and Romania can join EU not earlier than in 2007. Despite that macroeconomic situation is more stable and reform process is more advanced in Bulgaria, than in Romania, Bulgaria could not join EU in May 2004. Bulgaria is not much "worse" than new EU members. It seems that EU do not wish to leave Romania alone and separate these two countries into two groups.

[12] The origins of *Acquis* go to the early sixties (see Jørgensen, 1999).

[13] For detailed description of each Chapter see Annex 1.

economies. However, institutional development is a long and sophisticated process. Even being members of the EU, there still a room for further institutional improvement. Acceleration of reforms can lead not only to a deeper integration/cooperation with EU but also to a with deeper integration into the world economy. Furthermore, the *Acquis Communautaire* may represent an institutional anchor even for countries which are not considered as potential candidates to EU. Following Samson (2002), the adoption of some principles of the *Acquis* may help Russia to advance European integration and reform process. This does not mean that Russia should adopt the EU legislation (this is costly and will not be reimbursement by the EU as in case of candidate countries), but the "loan" of the part of the European legislation may help to lock Russians reforms.

3. Competitiveness and Acquis requirements: A critical review

The process of *Acquis*' implementation is endogenous: to be able to implement the *Acquis*, an accession country should already have quite well developed and functioning institutions. On the other hand, the *Acquis* itself can help to the institutional development in the accession countries. Institutional reform is based on the Copenhagen Criteria, which includes development of market economy, democracy, respect the rule of law and minorities rights and capacity to adopt the *Acquis Communautaire*. Piazolo (2000) argues that transition and accession process overlap with each other. He shows that requirements for EU accession are in line with transition process and help to lock market reforms. Namely, macroeconomic stabilization, the principle component of transition process, is in line with the Maastricht Criteria, required for the European Monetary Union membership. Reforms on the microeconomic level are necessary not only for transition but also for proper functioning of the market economy. And last, but not least, no reforms will be successful without well-functioning institutional framework: law defending property rights, two-tier banking system and central bank independence, viable law of contract and enterprise law. At the same time, all these requirements are necessary for the *Acquis Communautaire*.

However, the Acquis represents not only benefits but incorporate potential costs for acceding countries, or being a political instrument to influence the CEECs. The EU15 has fear of losing market shares and of increasing in competition from lower-cost CEECs, a considerable share of the agriculture also poses a problem for the EU15. On the other side, improvement in productivity, safety standards, higher standards in environmental and consumer protection may penalize acceding countries. Higher EU15 standards may cause an increase in costs and increase in prices for product from the new member-states. This may significantly reduce competitiveness of these countries.

As it was shown by Cvijetić (2000), high EU standards in social policy can reduce competitiveness of the new member-states. Moreover Cvijetić shows that harmonization of the environmental policy demands huge expenditures. Poland, for example, needs about 35 billions of euro for implementation of the environmental policy. Dziegielewska (2000) estimates costs of EU accession for Hungary, Czech Republic, Poland and Slovenia related to the environmental standards. Total investment for these countries varies from 2.7 billions of euro in Slovenia to 22.1–42.8 billions in Poland.

Free movement of labor is one of the hot topics of the current enlargement. The EU15 fears that workers of the new member-states will inflow into the western EU countries due to differences in income levels. Thus, the EU15 may apply restriction to the mobility from the new member-states up to seven years. Currently, only three countries do not apply such restrictions. However, restrictions to migration may imply additional costs for participation in the EMU since labor mobility represent a powerful instruments of adjustment to asymmetric shocks.

Experience of earlier enlargement doesn't show a risk for higher migration from poor countries. The European Integration Consortium estimate that the number of immigrants from the new member-states will not accede 0.1% of the EU15 population (without taking into account seven years of transition period), and will rise slowly, till 1.1%, during next 30 years.[14] Zaiceva (2004) also argues that potential migration pressure from the CEECs is law. She also proposes a brief review of studies estimating the migration from CEECs to EU countries, and emphasizes that huge difference in results is due to several specification and estimation problems. Zaiceva (2004) concludes that potential migration flows are not expected to significantly surpass pre-accession migration, which equals approximately 0.3 million of people. A potential migration is attended to be around 0.3–0.5 million of people. Zaiceva (2004) also predicts a future decline in migration flows, when income per capita in acceding countries will converge to the level of EU15. Migration between 2004 and 2014 is estimated to be around 3–5% of the CEECs population or about 1% of the EU15 population. Following this model, major migration flows are expected from Romania, Poland and Bulgaria into Germany, Austria, Italy and the United Kingdom.

Agricultural *Acquis* may also pose additional costs on the new EU members. Kiss and Weingarten (2002) analyze costs of *Acquis* adoption in the Hungarian diary sector. Potential costs of compliance with the *Acquis* are not very high for this sector for Hungary due to early modernization and strong investment support. However, state still need to support small farmers who likely to suffer from higher standards. The situation with agriculture in Poland is more problematic that in Hungary, and

[14] Boeri T., Brücker H. *The Impact of the Eastern Enlargement on Employment and Labour Markets in the EU Member States*. Final Report, European Integration Consortium, Berlin, 2002, cited in Kok (2003). P. 39.

compliance with the *Acquis* is more costly. In addition, Poland is the most penalized by the norms of veterinary and phytosanitary. These norms can also rise transaction costs for agricultural products. Negotiation process leaves a room for transition period, during which new member-states should achieve EU requirements. The most sensitive countries are Poland (485 premises) and Latvia (117 premises). Czech Republic, Hungary, Lithuania and Slovakia have from 52 to 2 premises.[15] During this transition period concerned products should be specially marked and not circulated on the EU territory except their home country. Note, that this requirements represents not only additional costs for producers but can also create a fear to bye "marked" products.

Finally, potential costs may incorporate even the adoption the EMU *Acquis*. Despite the fact that accessing countries will not introduce euro just after EU accession, this *Acquis* may be difficult to implement. Daviddi and Ilzkovitz (1997) show that productivity growth in the accessing countries is faster than in EU15. However, this catching-up process lead to the real exchange rate appreciation and, as a result, appreciation of the nominal exchange rate or higher inflation rate vis-à-vis EU15. From this point of view, transition process goes in the direction opposite to the accession process. Accession countries should have exchange rate stability and low inflation rate, but this is difficult to realize in the presence of the catching-up processes.

4. Are there any benefits from institutional convergence of the CEECs to the EU?

In the second part of the 90s, integration of the CEECs with the European Union has increased spectacularly. CEECs countries adopted the European model of development and approached their norms and standards to the EU ones. There is still a room for institutional development. In this section, we try to look what impact on economic development of CEECs could have a convergence of their institutions to the EU standards.

Piazolo (1999) uses a modified Barro's (1990) production function to measure the impact of institutional changes on economic growth in 25 transition economies. Piazolo (1999) constructs an indicator of institutional change (IIC) by summing nine EBRD transition indicators for 1998. This indicator varies from 9 to 45. The highest score corresponds to institutions in advanced economy and, hence, can be considered as the EU average. Piazolo (1999) obtains the following regression results (*t*-statistic in parentheses):

$$\Delta GDP_{1989-1998} = \underset{(6.76)}{-0.13} + \underset{(4.53)}{0.37}\hat{IIC} + \underset{(2.54)}{0.71}\hat{K}, \qquad R^2 = 0.53 \text{, where}$$

[15] European Commission (2003-b, p. 22).

$\Delta GDP_{1989-1998}$ — average percentage change in GDP between 1989 and 1998;
$\hat{K}$ – relative change of capital with respect to time;
$\hat{IIC}$ – relative change in indicator of institutional change:

$$\hat{IIC} = \left(\frac{IIC_t - IIC_{t-n}}{IIC_{t-n}} \right) / n.$$

This indicator is calculated under the assumption that all transition economies had low IIC score (i.e., IIC = 9) in the beginning of transition period.

We take the IIC values from Piazolo (1999) to calculate their impact on growth for ten CEECs. Thus, an increase in growth is calculated as

$$\frac{IIC_{EU} - IIC_{CEEC}}{IIC_{CEEC}} * 0.37 * 100\%$$

and is reported in table 2.

Table 2. *Increase in growth due to institutional convergence to EU*

		Increase in growth, %	
Country	**IIC in 1998**	**If IIC_{EU}=45**	**If IIC_{EU}=43**
Hungary	34	12.0	9.79
Czech Republic	33	13.5	11.21
Poland	32	15.0	12.72
Estonia	31	16.7	14.32
Slovak Republic	30	18.5	16.03
Slovenia	30	18.5	16.03
Latvia	27	24.7	21.93
Lithuania	27	24.7	21.93
Bulgaria	26	27.0	24.19
Romania	25	29.6	26.64
mean CEEC10	29.50	19.4	16.93

Source: Author's computation using Piazolo (1999) data.

According to table 2, the third column, the average increase in growth due to institutional improvements should be around 20%. We can break down all CEECs into three groups. In the middle of transition process, Hungary, Czech Republic and Poland had already institutions close to the EU average, hence the impact on economic growth is between 12% and 15%. On the other side are Bulgaria and Romania. Institutions in these countries are less developed in comparison with the other CEEC. Thus, these countries can benefit greater economic growth from the institutional convergence, equal to 27% and 29.6%, respectively. For Estonia, Slovakia, Slovenia, Latvia and Lithuania, the increase in growth varies between 16.7% and 24.7%. The growth rate is a little bit smaller but follows the same tendency if we consider the EU score equal to 43 (see table 2, forth column). Piazolo (1999) argues that one possible source of such convergence for the CEECs is the adoption of the *Acquis Communautaire*.

This approach, however, has several disadvantages. Different CEECs did not start reforms simultaneously. It means that initial level of reform process is different for a given year. Moreover, the EBRD does not measure institutional score for EU countries. It is not necessary that, on average, the EU has a maximum score for all institutions. We take as example the IIC for EU equal to 45 and 43, however this score can be lower. More recent data are already available. Finally, it could be interesting to study other areas sensitive to institutions, e.g., trade or investment, because institutions may have impact on growth in the long run or to have impact on growth with a lag. Both options are difficult to test for transition economies. Thus, we concentrate on institutional impact on trade.

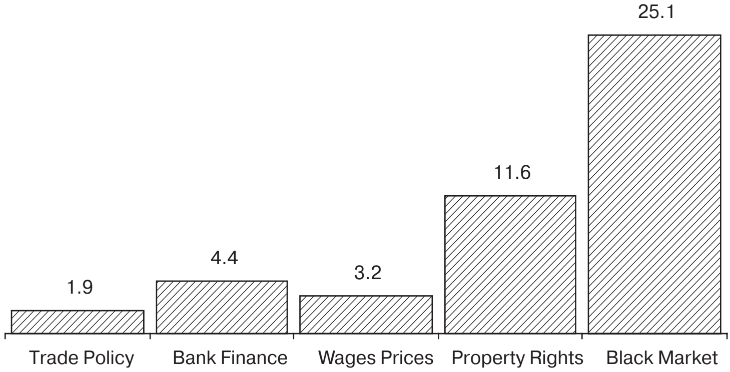
In Koukhartchouk and Maurel (2003), we test what trade increase can we attend from the institutional convergence toward the EU. We use the Heritage Foundation Index of Economic Freedom (IEF) as institutional proxy. The IEF provides score for a broad number of countries, including EU and CEEC, allowing to estimate the EU scores explicitly. In the first step, we estimate a gravity equation[16] with five components of the IEF enumerated in Figure 1. Further, we multiply the difference in institutions between CEECs and EU by estimated coefficients from the gravity equation. For each pair *ij*, we calculate the increase in trade due to institutional convergence to EU for *i* and *j*. Thus, we use the following formula:

$$\Delta LnTrad = \alpha_k (INST_i^{k=k(EU)} - INST_i^{k=k(CEEC)}) +$$
$$+\alpha_{k'}(INST_j^{k'=k'(EU)} - INST_j^{k'=k'(CEEC)})$$
$$\Leftrightarrow \exp\left(\Delta LnTrad\right) - 1 =$$
$$= \exp\{\alpha_k (INST_i^{k=k(EU)} - INST_i^{k=k(CEEC)}) +$$
$$+\alpha_{k'}(INST_j^{k'=k'(EU)} - INST_j^{k'=k'(CEEC)}\} - 1.$$

[16] The gravity equation is estimated for 42 countries over the period 1994–2001, giving 13,712 observations in total. The explanatory variable is log of bilateral trade. Regressors are logs of country's *i* and country's *j* GDP, distance between *i* and *j*, bilateral exchange rate volatility, institutional variables (IEF components), and a set of dummy variables to capture relations within and between trade in four blocs EU, CEECs, CIS and other countries. We estimate this equation by applying a Hausman-Taylor (1981) procedure.

Figure 1 shows the estimation results for five institutions.

Figure 1. *Potential increase in trade, %*



Source: Based on the data from Koukhartchouk and Maurel (2003)

We find that institutional improvement will significantly increase trade in ten CEECs. Essentially, this increase in trade is due to reduction of the un-official economy (25.1%) and improvements in a property rights protection (11.6%). Reduction of government intervention in banking and finance sector, wages and prices policy, as well as trade policy have moderate impact on trade. A total increase in trade due to institutional convergence is about 46%. Table 3 reports the breakdown of potential trade increase by country.

Table 3. *Impact of institutional improvement on trade in the CEECs*

	Potential increase in trade (CEECs→EU)									
	1st group			**2nd group**					**3rd group**	
	Estonia	Hungary	Czech Rep.	Poland	Latvia	Lithuania	Slovak Rep.	Slovenia	Bulgaria	Romania
Trade Policy	–8.9	0.0	0.0	0.0	0.0	–8.9	0.0	9.8	20.5	9.8
Bank Finance	–0.9	–0.9	–9.2	8.1	–0.9	8.1	8.1	8.1	8.1	17.9
Wages Prices	–1.3	–1.3	–1.3	7.9	–1.3	–1.3	7.9	7.9	7.9	7.9
Property Rights	5.8	5.8	5.8	5.8	15.6	15.6	15.6	5.8	15.6	26.2
Black Market	7.9	7.9	23.4	23.4	41.1	41.1	23.4	23.4	23.4	41.1
TOTAL	2.7	11.6	18.8	45.3	54.5	54.6	55.0	55.1	75.6	103.0

Source: Koukhartchouk and Maurel (2003).

From table 3 we can clearly see 3 groups. The most advanced are Estonia, Hungary and Czech Republic. In some cases their institutions are even better than the EU average. A trade increase for these countries is expected to be between 2.7% and 18.8%. Poland, Latvia, Lithuania, Slovakia and Slovenia constitute the second group with potential increase in trade varying from 45% to 55%. Bulgaria and Romania are considerably behind. Adoption of the EU institutions can double trade in Romania and increase trade by about 76% in Romania.

Our ranking of countries is similar to the ranking obtained from the Piazolo data. The main difference is observed for Estonia. It is considered as the most advanced in institutional reforms by the Index of Economic Freedom, but occupies an intermediate place following the IIC raking. We explain this variation by differences in the time period. As reported by the Heritage Foundation, Estonia has made such big institutional improvement only recently. That explains why this country was less advanced in reform progress in 1998. Note also, that the IIC score based on the EBRD indicators measures of reforms process, and the Index of Economic Freedom estimates the degree of state intervention into economy. Taking into account that market economy also assumes a low degree of state intervention, we can compare the IIC and the IEF scores.

The convergence of institutions is not necessary directly influenced by the *Acquis*. However, following Piazolo (2002), we consider that the CEECs can narrow institutional gap with EU through adoption and transplantation of the EU legislation. For example, all aforementioned institutions proxied by the IEF are covered by the *Acquis*. Trade Policy is enclosed partially in the "Free movements of Goods" (Chapter 1) and "Customs Union" (Chapter 25). Trade policy is also present in the Chapter 26 "External Relations" which is related to the WTO principles in community policy face to rules of anti-dumping and safeguard measures, measures against subsidized imports or illicit trade practices, quantitative restrictions and embargos. Banking and Finance is regulated by Chapters 3 "Freedom to Provide services" and 4 "Free Movement of Capital". Property Rights are protected by Chapter 5 "Company Law" and partially by Chapter 15 "Industrial Policy". Chapter 13 "Social Policy Employment" may have an impact on Wages and Prices. This does not mean, however, that changes in such institutions are purely determinated by the *Acquis* but following the *Acquis* requirements will lead to the institutional convergence. Reduction of the black market activity is also covered by the *Acquis*, e.g., Chapter 25 "Custom Union" requires that candidate countries should implement different measures aim to guarantee the protection of copy rights and industrial property rights, to fight against economic crime and organized crime, as well as against fraud and corruption.[17]

One more important remark should be added. Two simulations of institutional convergence exposed in the present paper calculate potential benefits from the

[17] See European Commission (2003-b).

institutional convergence but do not take into account potential costs of institutional transplantation and adoption. Both, growth model and gravity model, do not allow to introduce costs for institutions. By consequence, obtained qualitative results should be corrected taking into account critics exposed in the previous section. We believe, that the total effect of institutions on trade will be less but still significant, and that convergence of CEECs to EU standards represents more benefits that losses.

5. Conclusion

In the present paper we consider the *Acquis Communautaire* as the institutional anchor for economic development in the CEECs. We show that institutional convergence toward the EU standards may cause some damage for accession countries, especially in the field of safety standards, environmental protection, as it reduces countries' competitiveness. However, advantages of accepting EU institutions seems to outweigh the constraints imposed by EU. We show that institutional convergence in the CEECs toward the EU average represents potential gains in trade and economic growth. However, all empirical studies suffer from the absence of institutional costs in their models.

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Annex. *Description of the Acquis Communautaire by Chapter*

Ch.	Title	Description
1	Free Movement of Goods	The main objective of this chapter is to ensure free movement of goods on the whole territory of the EU. This suggests the unification of basic technical standards, product certification. All legislation in this domain is divided into two parts: harmonised (if product can be legally sold in one EU country it can be sold everywhere in the EU) and non-harmonized areas.
2	Free Movement of Persons	This Chapter focuses on the free movement of workers, the mutual recognition of professional qualifications (A fully qualified to practise a regulated profession person in one member-state can exercise this profession anywhere in the EU. Candidate country declares the equivalence of qualifications in question to their diplomas, which upon accession would be automatically recognized in the EU), the voting rights, the rights of residence and the coordination of social security schemes, including financial transfers related to the reimbursement of health care costs.
3	Freedom to Provide Services	Member-countries should guarantee a freedom of establishment and a freedom to provide banking, insurance and investment services and securities markets. The Chapter includes a minimal harmonisation of the authorization conditions, home country control and single licence, mutual recognition of national supervisory standards.
4	Free Movement of Capital (FMC)	The Chapter regulates not only FMC between member-states but also between member-states and third countries. Note, however, that member-states can retain certain restrictions in their relations with non-EU members. FMC includes, in particularly, payment and transfers of money over the borders, other transactions allowing transfer of ownership of assets and liabilities, like investment in companies and portfolio investments. It also covers payment systems, including cross-border credit transfers and prevention of money laundering.
5	Company Law	Covers company law itself, such as: its financial situation, raising, maintenance and alteration of capital of public liability companies, accounting law, protection of intellectual and industrial property rights (in particular for pharmaceutical products), the fight against piracy and counterfeiting, and the Community Trade Mark. It also includes regulation on jurisdiction and the enforcement of judgements in civil and commercial matters, and regulation on the law applicable to contractual obligations.
6	Competition Policy	The Chapter concerns in particular state monopolies of a commercial character, state aid, and control of mergers. Candidate country should be not only competitive but also capable to resist to competitive pressures of internal market. Candidate countries should have similar competitiveness environment as in EU.
7	Agriculture	The Chapter includes Agriculture Guarantee and guidance funds, quality policy, state aids, veterinary and phytosanitary legislation. Veterinary legislation covers control system in the internal market, identification and registration of animals, control at the external borders, animal disease control measures, anim al health-trade in live animals and animal products, public health protection, animal welfare and zootechnical legislation. The main aspects of phytosanitary legislation are harmful organisms, quality of seeds and propagating material, plant variety rights, plant protection products, animal nutrition. This Chapter provide regulation and legislation for the following products: arable crops, cereals, oilseeds and protein crops, rice, sugar, fibre crops, fruit and vegetables, wine and alcohol, bananas, olive oil, tobacco, milk and milk products, beef meat, sheep meat and pig meat.

Ch.	Title	Description
8	Fisheries	The Chapter determines access to resources, resources management, inspection and control (e.g. fishing quotas and effort licenses, efficient application of the satellite surveillance, establishment of a fishing vessel register, control for the implementation of a common market standards).
9	Transport	The Chapter focuses on different social, technical, fiscal, safety and environmental requirements in the road transport area, e.g. liberalization of the railway sector, safety *Acquis* in aviation and maritime sector, market access and infrastructure organisation in aviation.
10	Taxation	This chapter covers indirect taxation (VAT calculation on a unified basis), corporate taxation and excide duties.
11	Economic and Monetary Union	The Chapter concerns the euro adoption. Candidate country will participate in Economic and Monetary Union (EMU) from the date of accession. To adopt euro the country should fulfilled necessary conditions and participate in the Exchange Rate Mechanism for at least two years. This Chapter prohibits a direct financing of the public sector and privileged access of the public sector to financial institutions, and aims to ensure the independence of the Central Bank.
12	Statistics	The aim of this Chapter is to provide harmonisation of statistical bases. Candidate countries should provide data in permanent and sustainable way.
13	Social Policy Employment	The present Chapter covers different fields of labor law harmonization (e.g. collective redundancies, safeguarding of employment rights in case of transfer or undertaking, employer obligation to inform employees of the conditions applicable to the employment contract, guarantee for the employee in case of insolvency of the employer, posting of workers and organization of working time), equality of treatment between women and men (includes equal treatment in employment and occupation, social security, occupational social security schemes, parental leave, protection of pregnant women, women who have recently given birth and women who are recently breastfeeding), anti-discrimination (prohibit discrimination on a sex, racial and ethic origin, religion and belief, disability, age and sexual orientation), minimum health and safety standards for the working conditions, social protection system including insurance of a high level of health protection. Policy reforms and labor market transformations should be sufficiently developed to permit a full participation in the Single Market.
14	Energy	The Chapter includes energy sector restructuring, waste less energy and increase use of renewable energies.
15	Industrial Policy	The Chapter concentrates on general industrial competitiveness policy, privatisation and restructuring.
16	Small and Medium Sized Undertakings	The Chapter covers enterprise policy, distributive trades, tourism and social economy. The aim of this Chapter is to support economic development and resist to competitiveness pressure.
17	Science and Research	The Chapter ensures development of the European Research Area, funding of research, science and technology co-operation agreements.
18	Education, Vocational Training and Youth	The Chapter includes directives on equality of opportunity, safety in schools, facilities for minorities, education for the children of migrant workers.
19	Telecommunications and Information Technologies	The objective of this chapter is to provide convergence and competitiveness, including the establishment of independent regulatory authority for telecommunications and a separation of policy and law making authorities from ownership interests.

Ch.	Title	Description
20	Culture and Audio-Visual Policy	The Chapter concerns free-movement of television broadcasting, television advertising and the production of audiovisual programmes.
21	Regional Policy / Structural Instruments	Following this Chapter, candidate countries need to have the appropriate legal framework to be able to implement the specific provisions in this area.
22	Environment	This chapter focuses on environmental quality protection, polluting activities, production processes, quality standards for Air, Water, Nature protection, industrial pollution control, noise and nuclear safety, radiation protection, chemicals and genetically modified organisms, and climate change.
23	Consumers and Health Protection	The aim of the Chapter is to protect consumer interests in the internal market. The Chapter covers misleading advertising, product liability, doorstep sales, consumer credit, dangerous imitations, package travel and holiday tours, product safety, unfair terms in consumer contracts, time-share, distance selling, comparative advertising, prices on foodstuffs, guarantees for sale of consumer goods and injunctions, harmonization of consumer protection rules.
24	Cooperation in Justice and Home Affairs	The Chapter maintains and further develops the area of freedom, security and justice. This includes also Schengen *acquis*. The Chapter covers establishment of an independent, reliable and efficient judiciary and police organization. Candidate countries should be ready to implement standards on a border control, fighting with illegal migration, drugs trafficking and money laundering, organized crime; achieve adequate standards in police and judicial cooperation, data protection and mutual recognition of court judgements.
25	Customs Union	The Chapter includes Community Custom Code, Combined Nomenclature, Common Custom Tariff (trade preferences, tariff quotas, tariff suspensions and other custom-related legislation, such as legislation on pirated goods, drug precursors and export of cultural goods), effective protection and control of EU's external borders, improvement of internal coordination within and between custom administration.
26	External Relations	The Chapter focuses on Community's economic and trade relations with non-EU-members and international organizations. This Chapter covers a unified set of export and import rules, rules of anti-dumping and safeguard measures, measures against subsidised imports or illicit trade practices, quantitative restrictions and embargos.
27	Common Foreign and Security Policy (CFSP)	Under this Chapter, a candidate country should implement CFSP in a spirit of loyalty and mutual solidarity. National policies must be conform to the common position.
28	Financial Control	The Chapter includes financial control, internal and external audit regulations, protection of EU financial interests, control measures, including fiscal control, and the correct use control, monitoring and evaluation of EU funding.
29	Financial and Budgetary Provisions	The Chapter focuses on the rules concerning the organization, the establishment and the implementation of the EU budget.
30	Institutions	The Chapter covers the composition and functioning of institutions and bodies established under the Treaties or secondary legislation.
31	Other Matters	The Chapter "Other matters" includes a number of issues that were negotiated with the candidate countries and finally agreed in Copenhagen. This negotiations are largely uncontroversial but was not included into other Chapters.

Source: Completed by author using European Commission (2003-b).

Content

Препринт WP2/2005/01
Серия WP2
Количественный анализ в экономике
Редактор серии *В.А. Бессонов*

О.А. Бабецкая-Кухарчук

Схожесть и отличия процесса расширения ЕС и переходного процесса: Роль Общеевропейского законодательства (Acquis Communautaire) в институциональном развитии стран с переходной экономикой

(*на английском языке*)

Публикуется в авторской редакции
Выпускающий редактор *А.В. Заиченко*
Технический редактор *Ю.Н. Петрина*

ЛР № 020832 от 15 октября 1993 г.
Отпечатано в типографии ГУ ВШЭ с представленного оригинал-макета.
Формат 60×84. Бумага офсетная. Тираж 150 экз. Уч.-изд. л. 1,74. Усл. печ. л. 1,4.
Заказ №   . Изд. № 465.

ГУ ВШЭ. 125319, Москва, Кочновский проезд, 3
Типография ГУ ВШЭ. 125319, Москва, Кочновский проезд, 3

Для заметок

Для заметок