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EUROPE AND ITS NEIGHBOURS

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Abstract

The paper is an introduction to some of the issues that the enlargement, both in terms of memberships and association, will involve.

Many neighbouring countries have already asked for membership; the discussion centres around countries which belong to two well defined geo-political areas, with different economic characteristics. On the one hand there are the Countries of Central-Eastern Europe (CCEE) and on the Mediterranean Countries, or rather the other Mediterranean Countries (MC), that is to say non-members of the EU. Of the Central-Eastern European countries, the following have asked for membership of the EU: the Czech Republic, Slovakia, Poland, Hungary, Romania, Bulgaria and the three Baltic republics: Estonia, Lithuania and Latvia; in June 1996, Slovenia reached an agreement on membership of the EU. On July the 16th the European Commission has submitted to the Parliament a proposal for the widening of the EU called Agenda 2000, in which among other suggestions there is an indication of a first group of applicants possibly joining the union early next century; they are the Czech Rep. , Hungary, Poland , Estonia and Slovenia.

There are fewer applications for membership among the Mediterranean countries: Cyprus, Malta, Turkey and Morocco. In fact, Morocco has been declared to be inadmissible in 1986, but this does not imply that its request for membership should be denied in the future. Cyprus, the Greek part of it , seems to be a likely candidate, but that poses problems with Turkey which has been kept waiting since 1964. One must also consider the other countries, apart from Slovenia, born from the ashes of the ex-Yugoslavia, which obviously look keenly towards Europe, along with Albania and the other Mediterranean countries which have not yet asked for membership.

The political reasons for which the problems of expansion and association will be seen to be increasingly evident in the next ten years are clear. The Central-Eastern European countries are no longer under the influence of the former Soviet Union and are in a transitional phase from a centrally-planned economy to a market economy.

In the Mediterranean there are countries which are now receiving ‘association agreements’ with the European Union, notably Morocco, Tunisia and Israel, but these agreements lack a comprehensive approach to the problem of the integration of these economies into the Union. Trade aspects cannot be separated from the financial ones, from this point of view some indications should be taken from the example of NAFTA in North America.

At the same time the issue of enlargement implies a major reconsideration of the Common Agricultural Policy and a of the mechanism of transfer of structural funds to the poorest countries and regions.

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SECTION 1 - The problems of expanding the European Union

The debate on a single currency and on the Maastricht parameters must not overshadow another important problem which concerns the European Union (EU); that of its possible expansion. This is mainly a political problem, but it obviously has economic and financial elements which must be raised and clearly discussed. This paper is just an introduction to some of the issues that the enlargement, both in terms of memberships and association, will involve.

Many neighbouring countries have already asked for membership; the discussion centres around countries which belong to two well defined geo-political areas, with different economic characteristics. On the one hand there are the Countries of Central-Eastern Europe (CCEE) and on the Mediterranean Countries, or rather the other Mediterranean Countries (MC), that is to say non-members of the EU. Of the Central-Eastern European countries, the following have asked for membership of the EU: the Czech Republic, Slovakia, Poland, Hungary, Romania, Bulgaria and the three Baltic republics: Estonia, Lithuania and Latvia; in June 1996, Slovenia reached an agreement on membership of the EU[1]. On July the 16th 1996 the European Commission has submitted to the Parliament a proposal for the widening of the EU called Agenda 2000, in which among other suggestions there is an indication of a first group of applicants possibly joining the union early next century; they are the Czech Rep. , Hungary, Poland , Estonia and Slovenia.

There are fewer applications for membership among the Mediterranean countries: Cyprus, Malta, Turkey and Morocco. In fact, Morocco has been declared to be inadmissible in 1986, but this does not imply that its request for membership should be denied in the future. Cyprus, the Greek part of it , seems to be a likely candidate, but that poses problems with Turkey which has been kept waiting since 1964. One must also consider the other countries, apart from Slovenia, born from the ashes of the ex-Yugoslavia, which obviously look keenly towards Europe, along with Albania and the other Mediterranean countries which have not yet asked for membership.

The political reasons for which the problems of expansion and association will be seen to be increasingly evident in the next ten years are clear. The Central-Eastern European countries are no longer under the influence of the former Soviet Union and are in a transitional phase from a centrally-planned economy to a market economy. These countries are scheduled to join NATO, and it seems unlikely that they will be allowed to become members of NATO without also belonging to the European Union, or at least having a membership guarantee for the near future.

For the Mediterranean Countries the problem at the moment centres on the control and regulation of migration flows, but one must bear in mind the fundamental role of Egypt and Turkey in the Middle-East.

It is clear that the problem is not just that of formal membership of the EU, with full rights, for all these countries; the EU will probably remain confined and restricted for some time to the countries which currently form it. However, the EU must at the same time undertake initiatives which include political plans and especially economic strategies which incorporate the Central-Eastern European and the Mediterranean countries. In short, these countries will not become members in the near future, but they cannot simply be left out in the cold. This

[1] . For an analysis of the economies of the Central-Eastern European Countries and their relation with the European Union, see Boffito 1996.

raises again the problem of expansion, and it is therefore necessary to consider the problem of possible economic procedures involved in the expansion itself, bearing in mind that one is dealing with an economic integration of areas at differing levels of development and wealth.
Let us attempt to broaden our knowledge of the two groups of countries by examining some demographic and economic data concerning them. Table 1 provides a brief outline of the 'dimensions' of the two groups of countries and of the European Union.

Table 1. Europe and its neighbours

	Mediterranean Countries *	Eastern Europe**	EU
Population 1993 (millions)	204	109	370
Population 2010 (millions)	297	116	398
GDP 1993 (Billions US$)	362	224	6,785
GDP per capita (1993 - US$)	1,746	2,057	19,485
EU budget commitments (1994 - millions US$)	563	1,172	-

* Algeria; Cyprus; Egypt; Israel; Jordan; Lebanon; Malta; Morocco, Syria; Tunisia; Turkey
** Albania; Bulgaria; Czech Republic; Estonia; Hungary; Latvia; Lithuania; Poland; Romania; Slovakia; Slovenia.

Source; World Bank 1997, ‘The Economist’.

The different dimensions of the two areas are notable, not only do the Mediterranean Countries have roughly twice the population of the Central-Eastern European Countries, but the demographic dynamics are completely different (see table 2); thus in 2010 the population will be almost trebled and will be of a similar size to that of the EU at present. Around the year 2020 the population of North Africa and Turkey will outnumber that of the 15 European States[2]. The total GDP and per capita figures indicate the huge economic differences between the EU and the other two areas, which count for less than 1/9 of the European GDP when added together[3]. The huge opportunities offered by the size of the European market for the poorer neighbouring countries are clear.
Nonetheless, it is necessary to move on to a more articulated analysis of some data for the main countries, either as far as size of the population or economic strength is concerned. Let us look at data for five countries from each area[4] .

Demographic aspects
Table 2 presents some data relative to demographic aspects and human development, from which the large differences between the two areas can clearly be seen. The Central-Eastern European Countries have similar characteristics to those of Western European countries: low demographic growth rates, low infant mortality, long life-expectancy, high school enrolment ratios. The Czech Republic, Hungary and Poland all have a high Human Development Index, HDI, while the other seven countries have an intermediate HDI, with the Mediterranean countries lower than the others (with the exception of Algeria, which comes above Romania, cf. UNDP 1996, pp. 151-2).

[2] . See Pacini 1989, p. 46 onwards.
[3] . It is interesting to note that the ratio between the GDP of Mexico and that of the U.S. is circa 5%.
[4]. Obviously, there are countries like Israel, Palestine and Jordan which are of great geo-political importance.

In the Mediterranean countries the rate of demographic growth is around 2%, similar to that of India, and the rate for infant mortality is still very high. In Jordan the rate of demographic growth is above 5%. In short the Central-Eastern European Countries have already emerged from a process of demographic transition, while the Mediterranean countries are still undergoing the change. This fact implies the existence of different structures of the population; in Central Europe there is a distribution of the population whereby the various groups are of similar size, with a 'barrel' shaped structure. In the Mediterranean there is a 'pyramidal' structure, where the two age groups up to 20 years are larger than those above 20 years. We are looking at a structure which is still 'young', in which more than 50% of the population are under 20 years of age[5].

Table 2. Population and Human Development

	Population (millions) 1995	Pop. Avg. growth rate (%) 1990-95	Life-expectancy (years) 1995	Fertility rate (no. children) 1995	Infant mortality (per 1000) 1995	*Gross enrolment (%) 1992-94	Literacy rate (%) 1994
Algeria	28,0	2.2	70	3.5	34	66	59.4
Egypt	57,8	2.0	63	3.4	56	69	50.5
Morocco	26,6	2..0	65	3.4	55	46	42.1
Tunisia	9,0	1.9	69	2.9	39	67	65.2
Turkey	61,1	1.7	67	2.7	48	63	81.6
Bulgaria	8,4	-0.7	71	1.2	15	66	93
Poland	38,6	0.3	70	1.6	14	79	99
Czech Rep.	10,3	-0.1	73	1.3	8	70	99
Romania	22,7	-0.4	70	1.4	23	62	96.9
Hungary	10,0	-0.3	70	1.6	11	67	99

* Combined first and second level.
Sources: World Bank 1997; last two columns UNDP, 1997.

Notice that apart from Morocco all the ten countries present similar combined enrolment ratios, a possible indication of the quality of human capital, but in the Mediterranean countries literacy rates are much lower than in CEE countries. We can also see from table 2 that there are three countries which are particularly populated, namely Poland, Egypt and Turkey, but while the first has reached a fairly constant level, the others continue to grow with very high rates and the projections for the year 2025 for both Egypt and Turkey indicate a population of almost 100 million people. This fact indicates an important political problem, but it also indicates the potential, at least in theory, of the Mediterranean market in the next century.

Economic aspects

Table 3 provides a quick survey of the main economic features of the ten countries.

Table 3. Economics

	GDP	GNP per capita		Rate of inflation	Share of GDP (%) 1995	
	(millions US$) 1995	US$ 1995	Avg. annual growth(%) 1985-95	(%) average 1985-95	Agriculture	Investment
Algeria	41,435	1,600	-2.4	22.9	13	32
Egypt	47,349	790	1.1	15.7	20	17

[5]. This fact explains the pressure on the labour market which comes from the high percentage of individuals in the age group 9 to 19 years.

Morocco	32,412	1,110	0.9	4.8	14	21
Tunisia	18,035	1,820	1.9	6.0	15	24
Turkey	164,789	2,780	2.2	64.6	16	25
Bulgaria	12,366	1,330	-2.6	45.9	13	21
Poland	117,663	2,790	1.2	91.8	6	17
Czech Rep.	44,772	3,870	-1.8	12.2	6	25
Romania	35,533	1,480	-3.8	68.7	21	26
Hungary	43,712	4,220	-1.0	19.9	8	23

Source: World Bank 1997

Egypt is the country with the lowest income per head, i.e. with 790 dollars in 1995[6]. The remaining countries are middle income countries with many similarities among them. In many cases the economic growth has not overtaken that of the population, thus GDP per capita even diminished between 1985 and 1994. One should note that some of the Eastern European countries seem to be drawing towards the end of the transitional phase, in particular, Hungary, the Czech Republic and Poland have recorded GDP growth rates of above 4% in 1996. In Turkey the GDP has grown more than 5%. These four countries are part of the group of "Take-off Countries", which are capable of attracting capital and direct investments from abroad. With the exception of Tunisia, all ten countries have had very high rates of inflation, and in 1996, only the Czech Republic managed to reduce it to below 10%. However, one should note that since 1994 for some Central-Eastern European Countries there has been a significant process of recovery from high levels of inflation; the economic crisis remains serious in Bulgaria and in Romania. If we consider that in Italy and Spain agriculture accounts for about 3% of the GDP, we can see just how important agriculture remains for these countries. This is obviously an important gauge both as far as the move to an economic state of full industrialisation and the implications of a Common Agricultural Policy and the eventual joining of the EU are concerned. We are not dealing with countries closed to international business, on the contrary, exports are, as a percentage of the GDP, not dissimilar to that of China and South Korea; obviously, it is necessary to examine the composition of exports. Investment rates are similar among themselves, not particularly low and in line with European rates, but somewhat lower than the 'tigers' of South-East Asia, which sometimes reach 40% of the GDP. This data is not encouraging for countries which must still invest a lot to be able to raise their economic well-being.

In conclusion we are looking at countries which have undergone a serious macro-economic crisis, signalled above all by the fall of the GDP and by higher inflation, but which certainly have good growth capacities and which can be interesting market outlets for EU products.

Section II - Models of Possible Economic Integration

Although brief, the summary of these figures shows that the relationship between Europe and its neighbours raises a problem of economic integration, or at least of decent coexistence, between areas at differing levels of development. This process can be achieved in various ways, and one can see different examples in the world economy.

a. The European model: Transfers.

A first example is that of the European Union itself. In reality integration was initially created between countries with similar per-capita income levels; only in the cases of Spain, Portugal, Ireland and Greece joining can one discuss integration between areas of differing economic status. This example predicts considerable transfers from rich areas to poorer ones, as Table 4 shows. This transfer mechanism has been working for more than 10 years. Ireland receives between 2% and 4% of its GDP as net transfer from the EU and the same is true for Portugal and Greece. The Central-Eastern European countries and Mediterranean countries have much lower per-capita incomes compared to the 'poor' countries of the EU and should therefore receive proportionately more structural funds from the EU. Even if one limits the amount of

[6]. Egypt is just above the 750 $ per capita below which countries are classified as low income. Note that in Europe, Albania and Bosnia fall into this category.

per-capita transfer to around 300 ECU, as was the case with Greece in 1995, one can easily see that the transfer policy would be very exacting, since it would require an increment of structural funds of 105 billion ECU. Who would pay? Even if one considers the Central European countries alone, that would mean more than 30 billion ECU, with a 100% increase of the present amount of structural funds. But the Commission forecast an increase of these funds of only 10 billions ECU by 2006.

There are also the subsidies expected for the Common Agricultural Policy, CAP, and the fact that the countries on the waiting list have agricultural sectors which are much larger, both as a percentage of the GDP and of the labour force than those of the EU countries. How much should the CAP funds be increased when they are already more than 40 billion ECU? The European Commission says they should also increase by no more than 10 billions ECU by 2006; the general idea being that the overall budget should not exceed the 1.27% of the EU GDP. These figures imply a lot of restructuring both in the Structural Funds and in the CAP mechanisms, which are probably due anyhow.

The example of transfers can never be completely dismissed since it is part of the rules of the EU's constitution, that therefore each new member country must be included in this plan, but it is precisely for this reason that it is an illusion to think that membership can be granted in the near future to all the countries which have asked for it. The transfer model will continue to apply, but it will also need to be changed. Some small countries with relatively high levels of per-capita income among the Central-Eastern European countries, for example Slovenia, might be able to be members following the model of the transfers, but Poland presents much more serious problems. And how much money

Table 4. Contributions to the EU budget (1995)

	Net Contributions		GDP per capita
	Total (ECU millions)	Per capita (ECU)	(% of EU average)
Germany	13,431	164.6	106.7
Great Britain	4,720	80.7	98.2
Netherlands	2,005	129.7	100.4
France	1,727	29.6	107.2
Sweden	937	105.5	95.3
Austria	905	112.9	109.3
Italy	614	10.7	101.7
Belgium	311	30.6	110.4
Finland	165	32.3	92.5
Luxembourg	45	110.6	128.2
Denmark	-306	-58.6	112.0
Ireland	-1,887	-526.8	85.3
Portugal	-2,381	-241.8	67.9
Greece	-3,489	-333.0	60.0
Spain	-7,212	-184.0	76.1

Source: European Commission, 'The Economist'

should be transferred to the 80 million Egyptians and Moroccans who have a per-capita income in dollars of almost 1/10 of that of Greeks and Portuguese (see Table 3) and of 1/3 in PPP?

Therefore it is clear that if the model of transfers might work for some Eastern and Central European countries, it cannot be applied to the countries of the Mediterranean, something else will have to be devised. For the unsuccessful applicants the Commission thinks of establishing a permanent standing conference for possible new members, and of having “accession partnerships”, with rules and routines for future membership as well as indications about aid. It would be impossible not to include the Mediterranean countries in such a conference.

b. The model of free trade areas.

The model of transfers which may be conceivable for some Central European countries can certainly not be extended to Mediterranean countries where the per-capita incomes are lower and the population is double that of the Central-Eastern European countries. The European Union is steering itself towards the stipulation of bilateral agreements of free trade with Mediterranean Countries, also following the indications produced by the Barcelona Conference of November 1995, where a wish was expressed to set up a large area of free trade in the Mediterranean by the year 2010.

As far as the Central-Eastern European countries are concerned, the boost to economic growth which spring from trade with the EU are formidable. Table 6 shows how, in just four years, from 1988 to 1992, the EU has replaced the countries of the Eastern Europe and the former USSR as the most important commercial partner.

Table 6. Foreign Trade of three Central-Eastern European countries
(1988 and 1992, % of total exports)

	Czechoslovakia		Hungary		Poland	
	1988	1992	1988	1992	1988	1992
Total exports to: EU	20	50	22	50	27	58
East Europe / ex USSR	51	25	45	19	43	15
Total imports from: EU	22	42	25	43	27	33
East Europe/ ex USSR	50	31	44	24	43	17

Source: Heidensohn, p. 97: in 1992 the Czech Republic and Slovakia were not yet divided.

As far as the Mediterranean countries are concerned, some data must be borne in mind; the EU has a trade surplus with these countries of almost 10 billion ECU compared with 4.7 billion ECU development aid promised between 1995 and 1999, half of the amount destined for the Central-Eastern European countries. There is a relevant gap of almost 9 billion ECU per year for commercial policies aiming to rebalance the accounts with the Mediterranean countries, even bearing development aid in mind. Moreover, many of these countries export more than 50% to the EU (see Table 7).

Table 7. Europe and the Mediterranean

	Exports to the EU (1994, % of total)	Development aid from the EU (1992, % of total)
Algeria	67.7	78
Morocco	68.5	69
Tunisia	80.2	69.8
Egypt	55.8	40.4
Turkey	47.9	unavailable

Source: Eurostat, 'The Economist'

The potential benefits from the free trade policies would be especially of interest to the Mediterranean countries. In 1995 'Association Agreements' to the EU were reached with Tunisia, Morocco and Israel as part of the so-called MEDA Strategy. For Tunisia and Morocco, the agreements predict the realisation of an area of free trade over the span of 12 years, with preferential entrance for the two countries' agricultural products into the European market, but one can only think about a trade opening for these goods as taking place after 2000[7]. The agreements explicitly provide for active co-operation in the reduction of immigration, a preoccupation which reminds of NAFTA.

However, the International Monetary Fund recognises that in the short-medium term, the costs for Morocco and Tunisia will be much higher than the benefits. In particular they will have problems with the balance of payments because "the European exporters will benefit from the progressive lowering of commercial barriers in Mediterranean countries" is concerned. (*IMF Survey*, 11 November 1996, p. 38). In the case of Tunisia, "the costs of a short period transition could damage some sectors and increase unemployment" and "a third of businesses in the manufacturing sector may disappear" (*IMF Survey*, 4 March 1996, p. 78). Hence liberalisation concerns manufacturing in particular, where European firms are stronger, rather than agriculture, and this could cause serious problems to the manufacturing structure of Mediterranean countries which is still very weak. In the short-term, the EU's trade surplus with the Mediterranean countries could increase, subsequently creating the classic case of positive net transfers from the South to the North of the world, a case already experienced in the 1980s in Latin America, unless compensatory steps are taken in the capital markets and by funds for development aid. The process of liberalisation is therefore, in part, the opposite

[7] . For agreements between the EU and Maghreb countries see Zallio, 1996

of what one might expect; the primary aim should be to favour economic growth in the Mediterranean countries, and also to re-balance foreign trade which is currently most favourable to Europe, but it will not be like this in the short term. It is clear that many Mediterranean firms are less efficient than those in Europe, and the agreements call for measures to restructure them so that they should become profitable in the medium term. How much time is required in order to make the manufacturing industry of these countries competitive? Even in the light of a 'young' population, and therefore increased numbers competing on the local labour market, the question is if development can wait.

Furthermore, the lowering of tariff rates in the Mediterranean countries will involve a significant loss of fiscal revenue (*IMF Survey*, 11 November 1996, p.368), which will consequently worsen the state of public accounts.

Therefore, the model of free trade areas, although presenting great capacities, cannot resolve the problems of integration between strong and weak economic areas and cannot guarantee the convergence of the poorest countries towards the per-capita income levels of the EU. Relevant problems about the management of the phase of commercial opening and economic integration are raised, because of possible strong macro-economic imbalances in the short and the medium term. One must remember that these countries are already suffering from some problems: foreign debt, inflation, a poorly developed fiscal system and a trade deficit.

One of the aims of the MEDA strategy is also that of favouring development of intraregional trade between the Mediterranean countries, which currently stands at less than 5%.

c. The Asian model: Foreign Direct Investments.

A third example of economic integration is that which has developed in East Asia and in which Foreign Direct Investments (FDI) play a fundamental role. South East Asia is the area which has received the most foreign investment (see World Bank 1996a, p.95).

Table 8. FDI in East Asia - by source and destination (1986-92)

	Total Investment		Receiving economy (percentage of FDI from origin economy)				
Economy (region) of origin	Billions US$	% of Total	China	Indonesia	Malaysia	Philippines	Thailand
Hong Kong	21.7	34.3	62.8	7.6	3.1	10.4	17.1
South Korea	1.4	2.2	0.4	5.7	5.5	3.3	0.6
Singapore	2.6	4.1	1.3	3.8	6.8	1.5	9.5
Taiwan	6.4	10.1	6.4	8.0	22.3	2.7	8.2
Total NIEs	32.1	50.7	70.9	25.1	37.7	17.9	38.4
ASEAN	1.1	1.7	0.8	0.5	5.4	0.5	0.5
Japan	11.7	18.4	10.2	17.6	22.2	26.4	35.6
USA	6.9	10.9	8.0	6.8	10.8	36.9	13.6
Europe	6.5	10.3	4.4	16.1	19.6	11.7	11.0
Australia	1.0	1.6	0.6	0.8	4.6	2.0	0.9
Others	3.9	6.4	1.6	2.0	0.0	0.0	0.3
			billions of dollars				
Total	63.2	100.0	29.8	6.2	13.8	3.2	10.1

Source: World Bank,1996b, p.29

A substantial percentage of the FDI come from the same region, as Table 8 clearly shows.

The fact that often these investment flows are concentrated in few countries and also that the countries of origin are a limited number must be emphasised. From 1986 to 1992 over 80% of direct foreign investment in China came from five Asian countries: Japan and the four Newly Industrialising Economies, (NIEs): Singapore, Hong Kong, South Korea and Taiwan.

In Thailand the percentage of FDI form the NIEs is over 70% and as to the other South East Asian countries, only in the Philippines is the quota of investment from the USA significant.

A recent UNCTAD study underlines the fact that as far as direct investments to other take-off countries in Asia are concerned, (the so-called second-tier NIEs: Indonesia, Malaysia, the Philippines and China), the NIEs are today taking on a similar role to that played in the past by Japan (UNCTAD 1996, pp.81-5). In the 1960s and 1970s, Japan invested heavily in the four NIEs, helping their growth. In the second half of the 1980s the NIEs and Japan invested in other Asian countries.

FDI definitely played an extremely important role in the economic growth of South East Asia, but intraregional trade has dramatically increased over the decades. From 1980 to 1994 the exports of the developing economies of East Asia to other countries in the same area have increased more than nine times, compared with the five times increase of total exports to the whole world. Direct investments and the growth of intraregional trade have increased at the same rate.

UNCTAD suggests an interesting interpretation for the Asian example which would correspond to the development paradigm of the "flying geese" (UNCTAD 1996, p.75, 102-103) , because of the flight formation in an inverted V. As a matter of fact, there is a type of cycle of industrial sectors which, during the course of development, caters for the relocation of the labour intensive products to the poorer countries, while the richer country specialises in new products. There is therefore a 'leading goose' which leads all the others, and this 'leading goose' is obviously Japan. Foreign Direct Investments and also foreign trade are the means to transferring technological knowledge and capital in countries which are behind in the sector cycles. Table 9 illustrates this phenomenon, taking into particular consideration the modification of export flows of countries in the area. One should note that the manufactured exports represent 80-90% of total exports.

Table 9 . Total exports of some East Asian countries - principal destination, 1980 and 1994 (billions of dollars)

Exports from To		NIEs	ASEAN	Japan	World°°
World	1980	70.3	47.0	129.5	-
	1994	313.8	156.8	395.3	-
NIEs*	1980	6.4	8.0	19.1	88.0
	1994	58.4	39.9	93.2	365.8
ASEAN**	1980	6.3	1.5	9.1	39.3
	1994	41.6	7.4	40.5	166.7
Japan	1980	7.2	16.2	-	139.9
	1994	31.8	27.6	-	272.3
North America	1980	19.7	9.0	34.1	308.0
	1994	75.1	34.6	124.6	834.3
West Europe°	1980	13.6	6.7	21.5	902.4
	1994	43.7	24.6	65.6	1692.8

Source: UNCTAD 1996, p. 89.
* South Korea, Taiwan, Singapore, Hong Kong.
**Indonesia, Malaysia, the Philippines, Thailand.
°Includes East Germany from 1991.
°°These are imports as reported by the countries

The explanation for the success of East Asia following the example of the "flying geese" seems very convincing. Moreover, this model takes into consideration the role played by trade and investment policies which represented an essential part of the economic growth of this area. Attention should be drawn to the fact that the paradigm has worked well in the context of constant growth in the share in world trade of all the 'geese', (i.e. the countries) which take part in the flight formation. One can see from Table 10 that from the 1960s to today, the percentage of manufactured goods from Japan and the NIEs has more than doubled, from 10.5% to 21.9%. Or rather the export share of the NIEs has not grown to the detriment to that of Japan. The constant growth of the weight of these economies in the world market has provided a very favourable condition for their rapid economic growth.

Table 10. Shares of world exports of manufactures of NIEs and certain industrialised countries, 1965-1993 (percentage values)

Period	USA	Great Britain	Germany	Japan	NIEs
1965-69	19.1	10.6	17.1	8.5	2.0
1970-74	15.4	8.3	17.7	10.3	3.4
1975-79	14.4	7.9	16.9	11.1	4.8
1980-85	14.6	6.8	14.8	13.4	6.8
1986-90	11.9	6.2	15.6	13.3	8.6
1991-93	13.0	5.9	14.2	12.9	9.0

Source: UNCTAD, 1996, p.93

Section III - Foreign constraint and development finance

It will be interesting to see if the paradigm of the "flying geese" continues to explain the reality of South East Asia as well, especially given the strong economic growth of China and its entrance into international markets.

To obtain a more complete picture of the problems of integration for the Mediterranean countries and of the Central Eastern European countries with the EU, one needs to examine the position of these countries as far as foreign accounts are concerned.

Table 11 shows that in 1994 almost all these countries had a current account deficit, before official transfers, and notable percentages with regard to GNP. This problem already existed in 1980 and seems to represent an endemic disease for these countries.

Table 11. Internal and external constraint (1980 and 1994)

	Gross Domestic Savings (% of GDP)		Debt service (Actual, % of exports)		Current Account Balance (% of GNP)*	
	1980	1994	1980	1994	1980	1994
Algeria	43	27	312.1	28.0	0.8	-4.5
Egypt	15	6	13.8	15.8	-2.0	-1.3
Morocco	14	16	33.0	33.3	-8.6	-2.5
Tunisia	24	22	15.2	18.8	-5.0	-2.7
Turkey	14	23	28.2	33.4	-6.2	1.7
Bulgaria	39	21	0.5	14.0	5.1	1.9
Poland	23	17	29.6	15.0	-6.9	-3.1
Czech Rep.	-	20	-	13.1	-	-0.0
Romania	35	25	12.7	8.4	-	-1.0
Hungary	29	15	-	53.0	-2.2	-9.4

Source: World Bank 1996c. * Before official transfers.

In 1994 Turkey and the Czech Republic seemed to have fewer problems with foreign accounts, but in the last two years things have worsened. 1996 was also a bad year for Hungary and Poland, and a similar deficit is forecast for 1997 (‘The Economist’, 11 January 1997). The savings and investment ratios (see table 3) are obviously not the same as those of the NIEs and most of these countries therefore seem to be damaged both by a pressing foreign constraint and a shortage of internal saving. Literature on economic development draws attention to the phenomena relative to the existence of these deficits and names them Foreign Exchange Constraint and Saving Constraint respectively, or the "Two Gaps" (see for example Taylor 1991, pp.160-ff.; Grilli 1994, pp.151-2). Economic systems which have these two types of constraint certainly have difficulties in undertaking sustainable development processes in the medium to long term, especially from the macro-economic point of view. The problem of so-called development finance cannot be postponed for these types of countries. One must therefore analyse the role which foreign funding can play to compensate, at least in part, the shortage of domestic saving and of foreign currencies.

In the cases of the Central Eastern European and Mediterranean countries already examined, the existence of a considerable stock of foreign debt which manifests itself in the so-called problem of 'debt overhang' must be added to the weakness of domestic saving and to the existence of foreign constraint. This is a vicious circle so that the existence of a high foreign debt and the consequent debt service discourages foreign investors. There is a clear element of risk for new loans, since the country's resources should be used for the payment of the outstanding interest on the existing debt. There is therefore a problem with the relationship between new and old loans which, if unresolved, risks jeopardising influx of new capital[8] . One can also see that the index for the debt service has improved in almost all these countries. One must remember that in the first years of the 1990s, Egypt and Poland benefited from considerable cancellations of foreign debt.

The situation also discourages Foreign Direct Investments, since in theory eventual profits produced by local activity could be used, through taxation, to repay previous debts, but above all because of the macro-economic instability which is often implied in a high debt service.

An example of possible negative effects caused by the existence of a foreign debt is illustrated by Mexico's crisis of December 1994. In that case the international investors quickly abandoned the Mexican Government's bonds, called Tesobonos, leading to the devaluation of the Peso. The cause of the crisis seems to have been the very high current account deficit, which in 1994 reached 8% of the GDP. International investors kept the level of deficit inconsistent with an exchange rate of little over 3 pesos per dollar and caused a credit crisis. The peso was devalued by around 100% in just a few months, and short term interest rates touched 80%. There was also the possibility of a 'Tequila effect', that is to say, the possibility that the Mexican crisis involved other countries which had adopted monetary stabilisation policies and with a similar exchange rate system, firstly Argentina, which in effect underwent an increase of around 150 basis points on its own Brady Bonds[9] .

Among the Central Eastern European countries, Hungary appeared to be a country which could have followed the events of the Mexican economy because of the large current account deficit which reached 9.3% of the GDP in 1994 and a foreign debt-GNP ratio equal to 67%. A high current account deficit with regard to the GDP is therefore seen as an indication of possible financial crises and it is worth remembering that if Hungary has overcome the critical phase of the 1994-95 period then now the Czech Republic and Poland had deficits of circa 6% of the GDP and the Czech Republic actually had a trade deficit equal to 11% of GDP.

The other important element which emerged from the Mexican crisis concerns the nature of foreign financial support to a developing country, whether dealing with Foreign Direct Investments, bank loans or portfolio investments.

Table 12. Debt generating portfolio investments, gross flows per area
(1989-1995, billions US$)

	1989	1990	1991	1992	1993	1994	1995*
Sub-Saharan Africa	0	0	0	724	0	1,417	1,340
East Asia	260	872	2,993	5,749	13,358	22,424	23,691
South Asia	530	274	200	0	556	1,078	800

[8] . A documented and interesting analysis of financial problems and foreign debt of Eastern European countries can be found in Garavello 1996.

[9] . Argentinian state securities guaranteed by the U.S. Treasury Bonds, following a scheme created by the Brady Plan for the benefit of countries in debt.

Latin America	960	2,673	8,730	12,587	26,536	19,465	24,409
Europe & Central Asia	2,116	1,646	800	7,483	13,605	7,518	8,360
Middle East & North Africa	164	90	0	0	0	678	1,000
Total Developing Countries	4,030	5,555	12,723	26,543	54,054	52,580	59,600

Source: World Bank 1996a, p.101. *Preliminary

The debt crisis of the 1980s illustrated the fragility of the growth process which is founded on bank loans, which are typically short-lived. Portfolio investments , especially those in bonds, are *de facto* part of the 'hot money', that is to say typically financial investments with the aim of higher returns in the short- term, and it is these which caused the large ebb of capital from Mexico after December 1994. In short, the proportion between foreign direct investments and portfolio investments is a guide to the sustainability of the foreign debt. We have already seen in Figure 1 that the Central Eastern European countries registered a slight increase in foreign direct investments in the 1990s while there seems to be a substantial stagnation in the Mediterranean countries. Table 12 shows that portfolio investments are in a rather similar state even if something seems to have stirred in North Africa and the Middle East in recent years.

The Central Eastern European countries receive much larger portfolio investments than those of the Mediterranean countries, and these funds have recorded a considerable increase in the first part of the 1990s. The income from privatisation has increased considerably in the Central Eastern European countries and much less in North Africa and the Middle East(see World Bank 1996a, p.119)[10].

In June-July 1997 some Asian Countries have been touched by the 'Tequila syndrome' and they have been compelled to devalue their currency. The Thai Baht and the Philippines Peso lost 20-25% of their value to the dollar in a few weeks, the Malaysian Ringitt the Indonesian Rupiah lost much less. There are major differences between the economic conditions of these ASEAN countries, particularly the latter two ones, and those of Mexico in 1994, and apart from Thailand the situation does not seem to be too severe, but one must notice that these countries have exchange rate systems with much milder links to the dollar than those of Mexico and Argentina, and one would have expected that they should have been much less prone to a currency crisis. In any case the 'domino effect' of a regional currency crisis can be at work also in Asia and not only in Latin America; this is an important lesson to bear in mind when dealing with economic integration.

Section IV - Conclusions: which model of integration to follow?

East and South

The European Union is clearly following different approaches to possible integration of the Central Eastern European countries and of those of the Mediterranean basin. Hungary, Poland, the Czech Republic, Slovenia and Estonia have already successfully applied for membership and for the rest of the CEE countries it will be a matter of delay. The timing and costs of membership remain uncertain and both the Common Agricultural Policy and the Structural Funds Policy will be modified. But even for the successful applicants the integration process may be long and complex. The Central Eastern European countries do however have the advantage of having reached a level of commercial integration with the EU which is more advanced than that of the Mediterranean countries. They also have the ability to access to the international capital markets and the possibility of attracting Foreign Direct Investments. The costs of economic integration can be high, but the direction is clear. Hungary is a typical case of a Central European country which has received huge amounts of

[10] . The World Bank highlights the fact that in East Asia privatisation has not played an important role in the attraction of FDI (see World Bank 1996b, p.32).

FDI by Western European and American firms, which are then exporting most of their Hungarian output. In this case there are similarities with the US-Mexico relationship in NAFTA. But even for these countries there is the problem of the harmonisation of financial structures, a fact which opens an interesting chapter for the EU's financial and credit institutions.

The case is different for the Mediterranean countries. Not only is the per capita GDP lower on average than in the Central Eastern European Countries, but one is dealing with countries where four problems come to the fore:

i) These countries have not yet completed the process of demographic transition, in short, the growth rates of the population are still high. This implies that a section of the population is still extremely young; for example, in Algeria 24% of the population is aged between 9 and 19 years old compared with 14% in Hungary: consequently there are high levels of competition in the labour market. This fact obviously goes some way to explaining the large migratory movements from North Africa to the EU.

ii) The percentage of the population employed in agriculture and the share of agriculture on the GDP indicate that these countries are still in a phase of structural change which should lead them to a reduction of the share of the primary sector on the GDP. For the moment this sector continues to play an important role.

iii) In the Mediterranean countries, the quality of the human capital, which is now universally recognised as being one of the conditions which favours the growth process, is inferior to that of the Central Eastern European countries, where it is not dissimilar to that of Europe. In comparison to the literacy rates in the order of 93-99% for the Central Eastern European countries, we see rates which vary from 42 to 59% in North Africa and only Turkey scores 81%[11].

iv) The financial structures and the ability to participate in the international financial and credit markets are very modest throughout the whole of North Africa and the Middle East.

The EU's choice to proceed with bilateral Association Agreements for the Mediterranean countries can be justified in this historical situation, moreover it is not demanding financial and macro-economic commitments from these countries which they would find difficult to honour. For the Mediterranean countries the priority seems to be sustained economic growth with considerable improvements in Human Development. However, the nature of the Association Agreements is such that it does not seem particularly favourable to growth, moreover it does not take the process of structural change of the economy which these countries must undergo sufficiently into account. The liberalisation in the services and manufacturing sectors and the commercial limitations in the case of primary products risk endangering the fragile industrial structure of these countries and creating conflicts in commercial relations between the EU and the Mediterranean countries, especially as far as primary products are concerned, as is already happening to fishing products in Morocco. It appears necessary to proceed to a revision of the Common Agricultural Policy of the EU which takes into account the Mediterranean countries' needs for economic integration[12]. On the other hand, the Mediterranean and the Middle East represent important export markets in the medium term. The World Bank calculates that in the next ten years infrastructures will be necessary to a value of 300-350 billion dollars[13].

A NAFTA in the Mediterranean?

The economic relations between the EU and the Mediterranean countries, along with the socio-economic characteristics of these countries, pose problems which are not dissimilar to those which the United States faced with the NAFTA initiative to deal with Mexico. It is easy to see that the Mediterranean countries and Mexico have similar characteristics as far as the above-mentioned points i - iv are concerned. Moreover, the Mediterranean countries view the

[11] . See Table 2 and UNDP 1996, pp. 151-2.

[12] . From 1958 to 1992 the share of the EU's trade with countries of the Mediterranean basin remained substantially stable, it has in fact shown a slight decline from 10% to 9% (see Heidenson, pp. 15-6, 143).

[13] . In the Mediterranean the Israeli-Palestinian area is currently experiencing serious political and economic problems; unemployment in Gaza is at 63% and in the West Bank it is at 45%.

EU as a vast and rich market which is relatively close, like the US are to Mexico. As in the case of the US and Mexico the demographic and economic aspects explain the presence of considerable migratory flows from the South to North.

The plan for trade opening along with numerous investments from the United States in the so-called *maquilladora* industry south of the border led to high, if disorganised, economic growth in the northern states of Mexico. The conditions of re-entry to the United States of the goods assembled in Mexico are essential in this procedure. The commercial relationship is obviously rather unbalanced, but some observations on the effects of NAFTA are now available, and the agreement has determined a large influx of Direct Investments from the United States, even if the rather limited technological content often leads largely to pure assembly work. It will be interesting to see if these Foreign Direct Investments give rise to economic structures capable of supporting themselves, following the model of industrial districts, perhaps able to exploit external economies, as well as making use of low labour cost. Certainly for the time being the transfer of technology incorporated into the US Direct Investments into Mexico seems to be modest.

It must be stressed that important financial support, established by the Brady Plan to lighten Mexico's foreign debt, accompanied the trade agreement. The conditions set up by the Brady Plan have been extended to other countries, but not only was this initiative applied firstly to Mexico, but it was probably created specifically for this country. We have already seen that among the various conditions of the Brady Plan, there is that of supporting the issue of Mexican bonds, the Tesobonos, by the US Treasury. In short, the United States became the guarantors for the issue of new Mexican bonds into the international financial markets. This fact did not avert the crisis in Mexico in December 1994; however, it represents an essential element for a partial economic integration plan. In fact the commercial aspects of the integration process between the two economic areas were accompanied by explicit financial support from the US.

Europe can draw a lesson from the US-Mexico relationship of the last ten years. It is necessary to recognize the fact that the weakest economic area in addition to the liberalisation of trade necessitates the financial support of the stronger economic area, both in terms of flows of FDI and of a sort of financial guarantee in order to be able to enter the international capital markets. This involves a plan which may contribute to reducing the cost of the loan capital on the international markets, that is to say the 'spread' with regard to major interest rates, as the LIBOR, for the bonds of the weaker countries. This guarantee may also prove to be a substantial incentive for Direct Investments from the rich economic area. In the absence of a type of Brady Plan, it is unlikely that many Mediterranean countries will be able to overcome the negative effects of the 'debt overhang', of a low internal saving and of the foreign constraint. Economic growth will be fragile and highly uneven both between countries and inside each country.

The EU should therefore follow a strategy similar to that of the United States towards Mexico in dealing with the Mediterranean countries: free trade with financial support. But compared to Mexico, the Mediterranean area has the advantage of possible economic integration of the South-South type. There are notable potential advantages for North Africa and the Middle East which may be achieved by closer economic collaboration between these countries. A clear example is the mobility of the labour force, one need only think about the remittances of the Egyptians working in the countries of the Persian Gulf. An even more clamorous case of possible advantages could be obtained from economic co-operation between Israel, Palestine and the neighbouring countries. Israel obviously represents a type of 'North'. The effects of intraregional economic integration processes between the countries of North Africa and the Middle East, today limited to circa 5% of their foreign trade, may contribute to lightening the EU's burden in its economic relationships with Mediterranean countries. The Mercosur experience in Latin America might provide some indications[14].

[14] . This does not imply that regionalism has to be preferred to multilateralism, here I am concerned with the conditions which can favour the take-off of a region, or of some countries in a region. The experience of East Asia seems to indicate that the successful countries have been able to take advantage both of regional integration and of their competitiveness on world markets.

There are no easy and quick solutions to the issue of the widening of the European Union. However a comprehensive strategy needs to be outlined where the economic and social relations between Europe and its neighbours in the coming years can be recorded.

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