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Susanne Milcher, Ben Slay

The economics of the 'European Neighbourhood Policy': An initial assessment

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Abstract

This paper describes the general framework of the EU's emerging relationship with its new neighbours and investigates the potential economic impact of the European Neighbourhood Policy (ENP), both for the EU itself and for its neighbours. In particular, it seeks to develop an answer to the question of whether the ENP is sufficiently attractive so as to induce the governments in neighbourhood countries to adopt (or accelerate the adoption of) the types of economic and governance reforms that were implemented in the new member states during their accession processes. Although the specifics of the ENP are still being developed, the lack of incentives as regards to unclear accession to the EU is identified as the main weakness of the ENP.

Economically, the ENP seeks to ease trade restrictions through the implementation of legislative approximation and convergence with EU standards, before accessing the EU's single market can become a reality. Positively though, is that the access to the single market could improve significantly under the ENP. As experienced by the Central European states, FDI is instrumental to transform the economies of the Western CIS and the Caucasus. The ENP can be a supportive framework for improving investor confidence. Likewise, the new European Neighbourhood Instrument can add more coherence in technical assistance, and provide more financial support for creating capacities for trade infrastructures and institutional and private sector development. Finally, measures to promote increased labour migration between the new neighbours and the enlarged EU may be worth to put on the agenda for the future development and impact of the ENP.

1. Introduction[1]

The 1 May 2004 accession of ten new member states to the European Union brought deep changes to Europe's political economy, both vis-a-vis the new member states and in terms of the EU's 'new neighbours' to the east and south. In that same month, the European Commission formally presented the European Neighbourhood Policy (ENP) strategy paper, setting out a new framework for relations and financial support for the neighbourhood countries[2]. The European Commission President Romano Prodi described the goal of the ENP as seeking to create a 'ring of friends' around the EU, by offering close cooperation from political dialogue to economic integration. The initiative will allow neighbours to participate in major EU policies and programmes, and ultimately in the EU's single market. In this way, ENP participants are expected to form a relationship with the EU similar to that of the European Economic Area (EEA) members, such as Norway, Iceland, and Liechtenstein.

This paper describes the general framework of the EU's emerging relationship with its new neighbours and investigates the potential economic impact of the ENP, both for the EU itself and for its neighbours. In particular, it seeks to develop an answer to the question of whether the ENP is sufficiently attractive so as to induce the governments in neighbourhood countries to adopt (or accelerate the adoption of) the types of economic and governance reforms that were implemented in the new member states during their accession processes. This task is complicated by the fact that many of the ENP's specifics are currently unresolved, and the initiative itself not scheduled to go into effect until 2007. However, as of early 2005, it seems clear that incentives seem likely to be the ENP's weak point. While 'a significant degree of integration' for non-EU members is a goal, the ENP is meant as an alternative to accession[3]. This raises the question of whether the ENP offers a payoff that is large enough to elicit more rapid reforms and harmonisation with the EU legislation. What will be the benefits of ENP countries, beyond being in a 'neighbourhood'?

Formally, the ENP is both larger and smaller than the questions addressed in this paper. The ENP is larger in the sense that it addresses the North African and Middle Eastern countries that are engaged in the Euro-Mediterranean Partnership (Barcelona process)[4]. The ENP is also larger in the sense that it seeks to map out deep changes in the EU's development cooperation framework for these countries, in order to simplify and better coordinate the panoply of EU technical assistance instruments applied to these countries. This paper does not go into these details. By contrast, this paper focuses on the application of the logic of the ENP–particularly its 'market access and support for market reforms' promise that was intrinsic to the successful economic transitions in the new member states–to the economies of the Western CIS and the Caucasus that are the foci of the ENP. The scope of this paper is also broader than the ENP in that it examines many of these economic issues as they apply to the countries of Southeast Europe, even though these countries' relations with the EU are governed by accession processes rather than by the ENP. This applies to Romania, Bulgaria, Croatia and Turkey, which have received formal invitations from the EC to begin membership negotiations. It also applied to the countries of the Western Balkans (understood as Serbia and Montenegro, Macedonia, Albania, and Bosnia-Herzegovina) whose relations with the EU are governed by the Stabilisation and Association Process (SAP) which is explicitly

[1] The authors, Susanne Milcher, Ben Slay, are, respectively, policy specialist for poverty reduction and economic development, and director of the United Nations' Development Programme's Regional Centre in Bratislava. The views expressed in this paper do not constitute official positions of UNDP.

[2] Verheugen, G. (2004).

[3] Verheugen, G. (2004) and EC. (2004b).

[4] Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Syria, Tunisia, Palestinian Authority.

intended to ultimately lead to their accession. Some aspects of the paper also apply to the Russian Federation, which likewise remains outside of the ENP[5].

This paper investigates possible impacts of the ENP on economic and political development and income convergence in the participating countries. Section 2 describes the policy's main objectives and principles. Section 3 presents an overview of each country's current economic situation and makes sub-regional comparisons. Section 4 presents possible economic and political effects. Section 5 concludes.

2. The European Neighbourhood Policy

In March 2003, the Commission proposed a communication on the '*Wider Europe Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours*' outlining the basic principles of the European Neighbourhood Policy. In October 2003, the European Council at Brussels endorsed this initiative and encouraged the Commission to take it forward. The Commission then started explanatory discussions with two of the three East European states that have Partnership and Cooperation Agreements (PCAs) in force, Ukraine and Moldova. This led to the development of the strategy paper outlining the ENP's main principles that was released in May 2004.

The ENP can be understood as having three main purposes. First and most generally, the ENP seeks to surround the enlarged EU with a 'ring of friends' who share the EU's values and pursue security and other foreign policies that are broadly consistent with the EU's.

Second, in order to do this, the ENP will offer these countries significant improvements in access to the single market and expanded technical assistance. In this way, the ENP seeks to offer its neighbours the kind of 'market access for reform' grand bargain that was instrumental in the dramatic improvements in governance institutions that the new member states experienced during their accession processes of the 1990s. The experience of the new member states suggests that the largest benefits of convergence towards European standards can come in the form of foreign direct investment (FDI) that can be attracted by geographic proximity and preferential access to the single market. As the new member states' experiences show, this FDI can have unparalleled advantages in terms of restructuring and modernising unreformed manufacturing, energy, and financial sectors. The EU also seeks in this way to moderate the potentially negative effects of the new Schengen borders on its new neighbours.

Third, the ENP represents an implicit recognition of the fact that the EU's further expansion, in terms of the accession of new members in the CIS, is not anticipated. In contrast to the SAPs now on-going in Southeast Europe – which are seen as preparing these countries for eventual EU membership – the ENP is to be an alternative to EU membership. Such an option may seem unpalatable to the countries of the Western CIS (particularly Ukraine) and the Caucasus that ultimately aspire to full EU membership. This underscored the importance of ensuring that the benefits of ENP membership – and the process of attaining them – are sufficiently attractive.

National action plans drawn up by the Commission and neighbourhood countries will be the ENP's main operational framework. These action plans will cover five year periods and are to be renewable by mutual consent. They are to build on existing cooperative frameworks, such as the bilateral partnership and cooperation agreements (PCAs) with Ukraine and Moldova that were signed in 1994 and went into force in 1998. The PCAs will continue to form the legal basis for relations; the ENP action plans will set out the framework for their realisation. (In Southeast Europe, the relations between the EU and partner

[5] The EU's partnership with the Russian Federation is to be developed within the framework of the 'Common European Economic Space' announced at the Russo-European summit in May 2002 (Mau, 2004).

countries will be conducted within the framework of accession and the stabilisation and association agreements). At the St. Petersburg Summit in May 2003, the EU and Russia decided to develop four common spaces: a common economic space; a common space for freedom, security and justice; a space for cooperation for external security; and a space for joint research and education. Energy is a key element of the overall relationship. In the Russian case, the ENP is to serve as the legal framework for deepening and structuring these bilateral agreements and programmes[6].

In addition to performing a host of functions[7], the action plans are to describe the processes by which the new neighbours will attain preferential access to the single market. The action plans are intended to ultimately bring most of the EU's trade with the new neighbours under the EU's common external tariff regime. They will also seek to ensure that trade flows during this transition are governed by WTO principles. For example, by facilitating convergence with EU food safety regulations, the national action plans should improve prospects for the new neighbours' agricultural exports on the single market. Given the importance of foodstuffs in the commodity composition of their exports[8], this combination of liberalised market access and technical assistance could yield extensive benefits for the neighbourhood economies.

The anticipated creation of the European Neighbourhood Instrument (ENI), which is to be put in place by 2007 (in time for the start of the EU's new 2007-2013 financial perspective), will be the ENP's technical assistance instrument. It will also be a key incentive for inducing neighbouring country participation in the ENP. This new financial instrument, which will support cross-border and regional cooperation projects, is slated to replace some existing technical assistance instruments (e.g., TACIS programming) while better complementing others (e.g., INTERREG). In principle, the ENI will facilitate funding applications under a single administrative framework for cross-border programmes that would both span and fall within the EU's new frontiers.

For the 2007-2013 period, the Commission intends to substantially increase the annual amounts to be allocated to the European Neighbourhood Instrument (relative to the 266 million euros in comparable technical assistance programmes available for the 2004-2006 period)[9]. However, if this is to be the only incentive in place, the ENP will most likely remain a very modest development cooperation mechanism, relative to the development challenges of the new neighbours. This underscores the importance of the ENP's prospects for fostering the 'market access for reform' grand bargain that the new neighbours would need to attract transformative amounts of FDI.

3. Economic situation of the 'new neighbours'

GDP levels, trends, and compositions vary sharply among these countries. In general terms, GDP growth in the CIS economies significantly exceeded EU averages during the 2000-2004 period (cf. Figure 1), with particularly high growth rates noted in Armenia and Azerbaijan, but also in Ukraine. Strong growth is noted across virtually all components of domestic demand as well as exports. Fiscal accounts in these economies have been generally in balance, if not in surplus. In some countries (Russia, Ukraine), these fiscal

[6] A PCA was also signed with the Russian Federation in 1994, and went into effect in 1997.

[7] These include: (1) promoting political cooperation (with a particular emphasis on security issues); (2) providing the new neighbours with improved access to EU programmes in the areas of education and research and development, and to European infrastructure networks in the fields of energy, transport and telecommunications and environment; and (3) justice and home affairs, particularly as concerns issues of border management, migration, trafficking in human beings, drugs and arms, and organised crime.

[8] See Aaslund and Warner (2004) for more on this point.

[9] EC. (2004b).

surpluses have been accompanied by external surpluses as well. By contrast, economies in the new EU member states and Southeast Europe typically exhibited large external deficits that have been financed by equally large inflows of FDI, portfolio investments, and bank lending. Fiscal deficits in the Central European economies also expanded during this time, earning these countries warnings from the European Commission (if not financial markets).

Despite the high growth rates, distances to the CIS economies' 1990 GDP levels remain large. Although statistical problems and extensive structural change make such 'before and after' comparisons problematic, it is noteworthy that Russia at the end of 2004 was still some 18% below its 1990 GDP level. Large gaps were likewise reported for Ukraine (35%), Moldova (37%), and Georgia (40%)[10]. This underscores the fact that the post-1999 recovery experienced in these countries is based largely on 'recovery growth' based primarily on the employment of previously idle human and physical capital. Without inflows of fresh capital and the technological transfers they embody, this growth may not be sustainable.

Likewise, although the new neighbours' fiscal (and in some cases external) surpluses are sometimes described as signs of health, they can also be seen as reflections of underdeveloped financial systems and unfriendly investment climates. While showing the benefits of strong economic growth, budget surpluses also reflect shallow financial systems that are unable to channel domestic savings into government debt at affordable (for the budget) interest rates. Fiscal and external surpluses also reflect foreign investors' unwillingness to invest in these economies, necessitating either current account surpluses (e.g., Russia, Ukraine) or significant inflows of concessionary lending in order to finance current account deficits (e.g., Armenia, Georgia, Moldova).

By contrast, the current account deficits (cf. Figure 2) reported in most of the new EU member and accession countries (Bulgaria, Croatia, Romania) are smaller than those recorded in the Caucasus and Moldova. They have generally been financed by substantial inflows of FDI and equity portfolio investments[11]. Such inflows are signs of health and improving international economic competitiveness. To a large extent, they result from convergence in regulatory, governance, and business climates towards EU standards in these countries – which in turn is a reflection of their progress in EU accession and integration. Prior to their May 2004 expansion, EU-15 countries accounted for 70-80% of exports from Poland and Hungary. The EU shares of Czech and Slovak exports were somewhat smaller, owing to the continuing relatively large role of Czech-Slovak exports. As Figure 3 shows, exports to the EU-15 account for more than 50% of the total for from Bulgaria, Croatia, and Romania. It remains to be seen whether the ENP can deliver the same benefits to Europe's new neighbours.

Convergence toward EU regulatory standards may not matter much if the ENP does not significantly improve the new neighbours' access to the single market. Existing trade regimes are not particularly promising in this respect: the PCAs that govern the new neighbours' trade with the EU 'are little but codification of WTO principles for non-WTO members'[12]. At present, EU export shares of the CIS countries are significantly lower than those of the new member states and the Southeast European countries (cf. Figure 3), even after controlling for structural reform and distance from the EU market. For example, Ukraine's exports to the EU-15 do not even reach 20% of total exports. Aaslund and Warner argue persuasively that these low shares can be attributed to these countries' lack of preferential access to the EU's single market[13]. The EU's effective protection is especially high for agricultural goods, textiles, chemicals, and steel – goods that play a particularly large role in the commodity composition of CIS

[10] World Development Indicators database, adjusted for estimates of 2004 data.

[11] The relatively large FDI inflows shown for Armenia, Georgia, and Moldova in Figure 2 are somewhat misleading. They tend to reflect one-off privatisation sales and debt-for equity swaps, and are small relative to these countries' current account deficits.

[12] Aslund and Warner (2004).

[13] Aslund and Warner (2004).

Figure 1. Average annual GDP growth (%), 2000-2003

Figure 1a. Caucasus

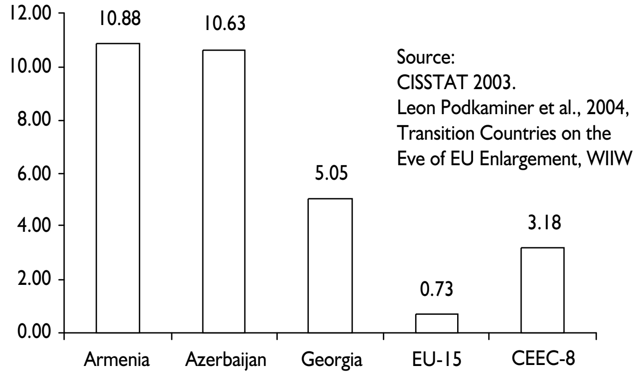


Figure 1b. Western CIS

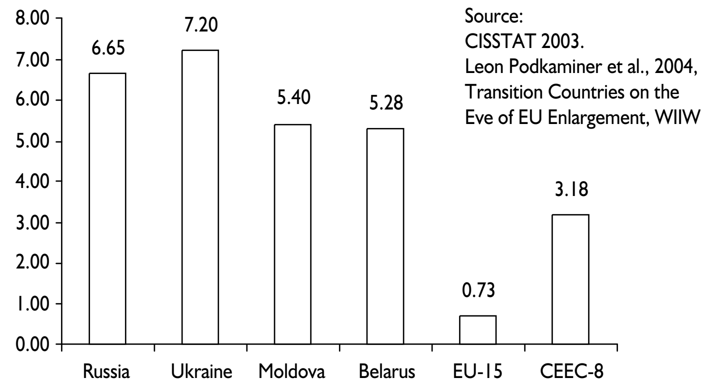


Figure 1c. Western Balkans

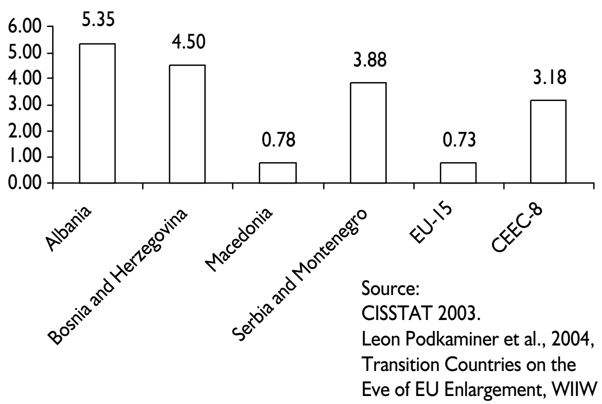
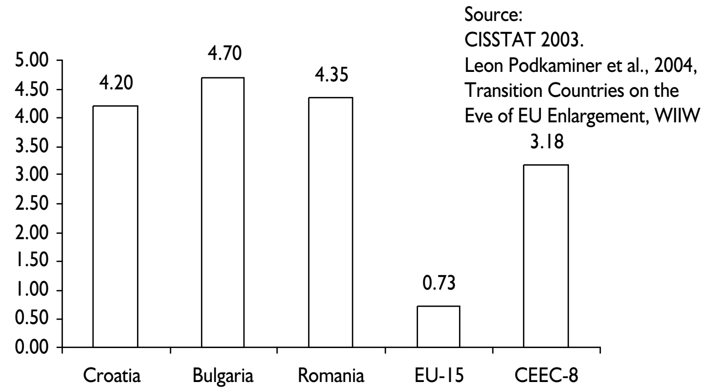
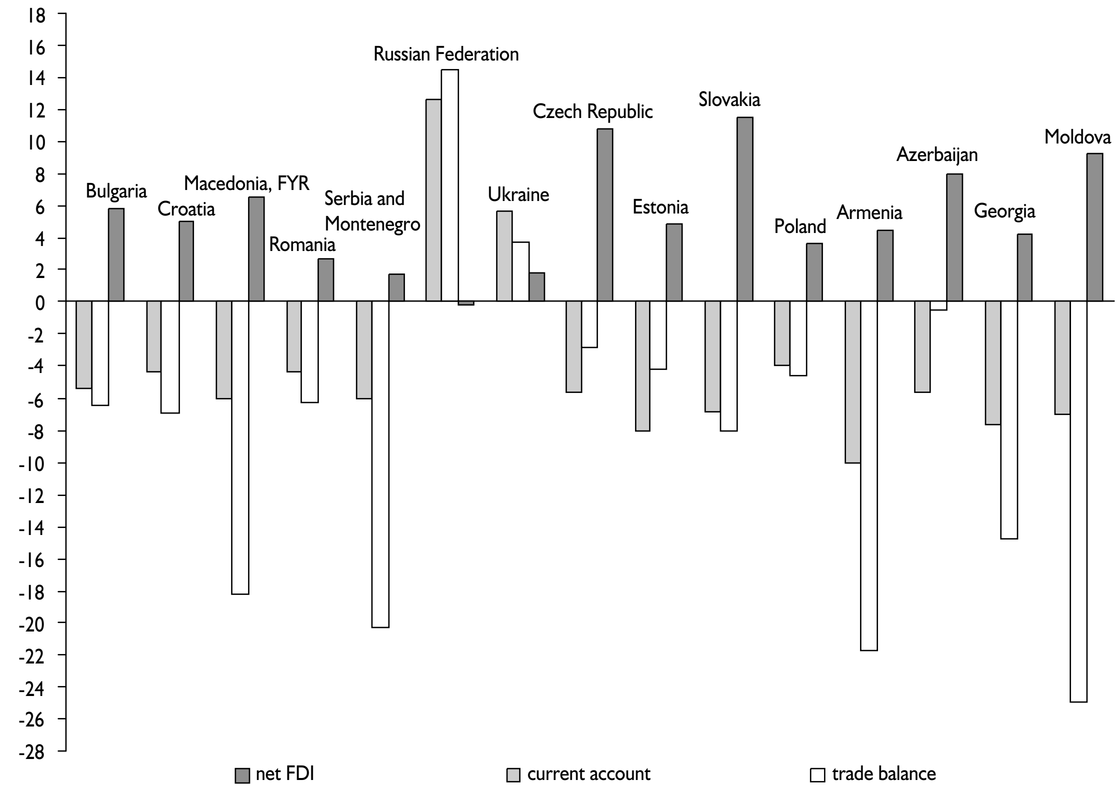


Figure 1d. Accession countries



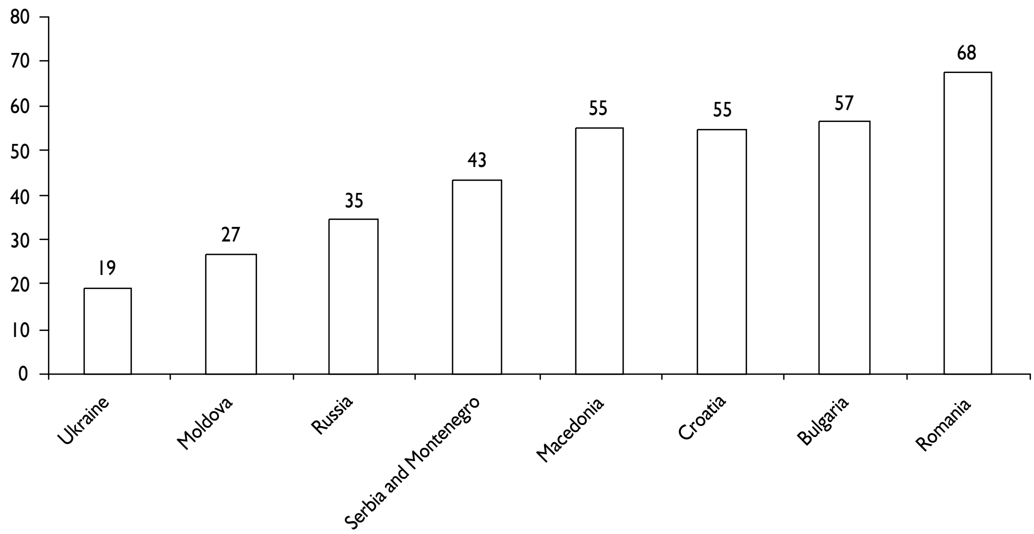
exports. In this sense, EU trade policies create obstacles for export and GDP growth for CIS countries. By the same token, significant improvements in access to the single market could have a major positive impact on the new neighbours' prospects for exports and export-related FDI.

Figure 2. Current account, trade balance and net FDI (% of GDP), average 2000-2002



Source: World Development Indicators 2004.

Figure 3. Exports to EU-15 (% of total exports), 2003



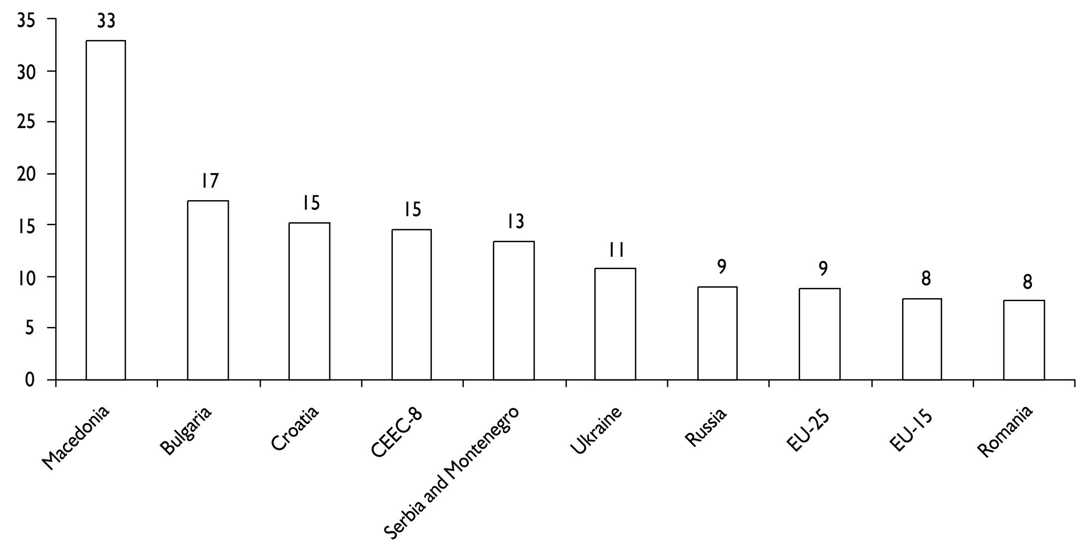
Source: CISSTAT 2003. Leon Podkaminer et al., 2004, Transition Countries on the Eve of EU Enlargement, WIIW.

The situation is somewhat different in Russia and Azerbaijan, owing to the large role of oil and gas (which are not subject to extensive protection) in their commodity composition of exports. The deployment of the Baku-Tbilisi-Ceyhan oil pipeline in 2004 will increase Azerbaijan's importance as an energy supplier for the EU. Russia is the EU's fifth largest trading partner (after the US, Switzerland, China, and Japan). The enlarged EU is Russia's largest trading partner, accounting for more than 50% of its total trade; some 40% of Europe's gas supplies come from Russia[14]. Likewise, oil exports make Azerbaijan the EU's largest trading partner in the Caucasus, although some studies suggest that even in Azerbaijan, foodstuffs, cotton, and textiles could play a large role in the country's export basket[15].

FDI-led restructuring of manufacturing, energy, and finance sectors, as was the case in the Central European countries, can be a second important determinant of integration. Since 2000, expanded privatisation programmes in Southeast Europe have attracted significant FDI from EU-focused multinationals. FDI inflows have shifted from new EU member states to Southeast Europe[16]. In contrast, most of the FDI flowing into the Western CIS countries comes from Russia, which reported relatively large outward FDI flows during the 2001-2004 period.

As was earlier the case in the Central European economies, recovery growth and elements of FDI-led industrial restructuring are now generating improvements in labour productivity in both the CIS and Southeast European economies. When combined with slow or negative labour force growth and (in some cases) declining employment, this labour productivity growth has been accompanied by high unemployment rates in most 'new neighbour' countries (cf. Figure 4) – particularly in the Western Balkans[17]. More generally, despite the current high growth rates, these economies continue to suffer from inadequate business infrastructure, difficult regulatory climates, elements of corruption in public administration[18], high unemployment rates, and significant degrees of human insecurity.

Figure 4. Average annual unemployment rate (LFS), 2000-2003



Source: CISSTAT 2003. Leon Podkaminer et al., 2004, Transition Countries on the Eve of EU Enlargement, WIIW

[14] EC. (2004d).

[15] Centre for Economic Reforms, (2005).

[16] Podkaminer, L. et al. (2004).

[17] Mizsei and Maddock (2005).

[18] cf. table 1, page 15.

4 Possible impact of ENP

Can the ENP help to replicate the Central European transition successes in the new neighbour countries? Will the 'market access for reform' bargain implied by the ENP lead to dramatic improvements in market access, export-oriented FDI, restructuring, and modernisation?

Optimists on these points must face two key questions. First, the neighbourhood countries are poorer and more heterogeneous than the Central European countries. This is apparent both in economic issues (per-capita GDP levels, overall size, structural characteristics) and political terms. A successful 'market access for reform' bargain for Moldova would necessarily look different than one for the Russian Federation. Second, the ENP is unlikely to be seen as a fully satisfactory substitute for eventual EU membership – particularly by reformist governments (e.g., Ukraine after the 'orange revolution') who are most likely to desire accession. Both of these factors are likely to weaken to the stabilising effect of the 'European anchor'.

For the 'market access for reform' bargain to work, the economic benefits of the ENP must be seen to be positive and significant. Previous experiences with the extension of the single market to non-EU countries, such as Norway, Switzerland, or Liechtenstein, offer hope in this respect. However, the neighbourhood countries have lower quality infrastructure, lower per-capita GDPs, and much greater political risk. This increases the importance of other elements of the ENP, particularly financial assistance and infrastructure development (especially in the energy and transport sectors)[19]. Likewise, European integration for these economies could have some downsides, particularly in terms of trade diversion, but also (particularly for Azerbaijan) the possibility of further specialisation in the export of raw materials that can mean heightened vulnerability to terms-of-trade shocks, as occurred in 1998.

4.1. Economic policy, trade and the single market

The ENP could bring substantial efficiency and welfare gains to neighbouring countries via liberalised access to the single market. Legal changes in the areas of customs and financial services should promote trade facilitation and business creation. Better market access, combined with enhanced dialogue and cooperation on social and employment policies, could encourage reforms directed at reducing poverty and increasing the effectiveness of social assistance.

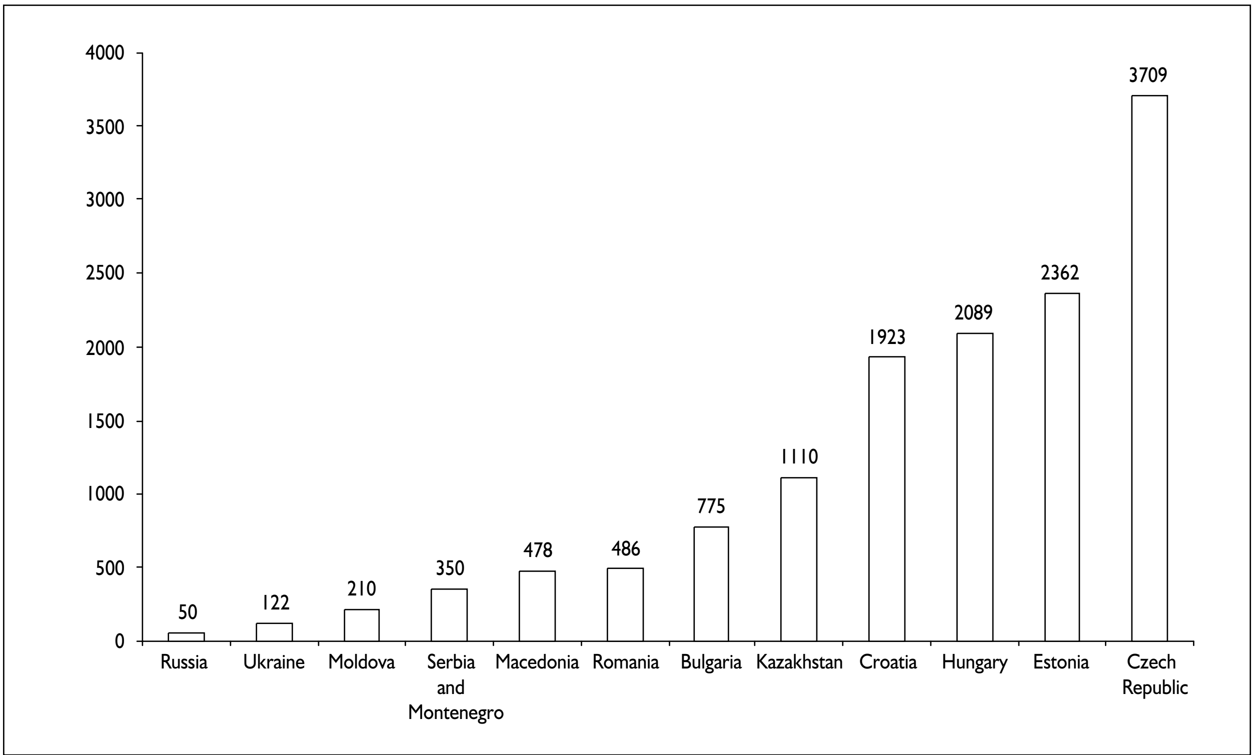
The bilateral EU association agreements concluded with the Central European countries in 1991, which provided asymmetric access to the single market for Central European exporters, may be instructive in this respect. In addition to encouraging rapid growth in trade overall and towards the EU in particular, the association agreements (combined with ambitious privatisation programmes) promoted significant FDI inflows, attracted by 'export platform' possibilities[20].

While this pattern seems now to be taking hold in Southeast European countries now negotiating for EU membership, it may be less replicable in the countries of the Western CIS and the Caucasus. Thanks to their accession and SAP agreements with the EU, the Southeast European countries already enjoy preferential access to the single market (relative to CIS countries). During the past few years the Southeast European countries have attracted significant FDI inflows, many of which came from EU-focused companies. However, recent increases in FDI in the Western Balkans appear to be largely due to progress in privatisation programmes. This also means that FDI in the Western Balkans is likely to involve

[19] Dodini, M. and Fantini, M. (2004).

[20] Martin, C. and Turrion, J. (2001).

Figure 5. Cumulative FDI inflows per capita 1989-2003, USD



Source: EBRD (2004) Transition Report update.

restructuring and hence job losses[21]. By contrast, most FDI in the new EU member states is of the green field variety, and hence more likely to be job-creating. The Southeast European economies have the opportunity to experience this phase in the next few years. In Romania, thanks largely to FDI, the share of machinery and transport equipment in total exports (22%) now exceeds the share of textiles and clothing in total exports (20%)[22]. On the other hand, intra-Balkan trade remains heavily dependant on local developments, since intra-regional trade accounts for a large share of exports in this sub-region.

By contrast (c.f. Figure 5), privatisation in CIS countries has generally been focused on sales to domestic investors, and Russian capital or 'round tripping' domestic capital typically plays a large role in the relatively small FDI that has come in. Perhaps for this reason, significant changes in the commodity composition of exports have yet to be registered. In Moldova, for example, food products and textiles account for almost 50% of total exports, while mineral products and machinery and equipment take up almost 40% of total imports[23]. The end of preferential access to markets in Poland and other Central European countries that came with their May 2004 EU membership will result in at least some trade diversion: losses for Ukrainian producers are estimated at about 1% of exports in 2004-2005. Whether improved market access and greater support for market reforms that could come with the ENP will be sufficient to generate a breakthrough in this respect remains to be seen.

The ENP's focus on energy safety and security (as is explained in the Communication on the development of energy policy for the enlarged European Union, its neighbours and partner countries) is a potential opportunity for the new neighbours, both energy producers (Russia, Azerbaijan) and energy transporters (Ukraine, Russia, Belarus, Georgia, Azerbaijan). The national action plans will build on existing bilateral or regional energy and transport initiatives, such as the EU-Russia Energy Dialogue, the Inogate

[21] Mizsei and Maddock (2005).
[22] Podkammer, L. et al. (2004).
[23] EIU (2004).

Programme dealing with the Caspian basin, the TRASECA transport project, and the South-East Europe Regional Energy Market. These initiatives have helped establish a roadmap for institutionalised partnership, with concrete measures to harmonise the legal and regulatory framework for energy sectors. Increased energy efficiency, the use of renewable energy, and cooperation in energy technologies are also promoted by these programmes.

4.2 Cross-border issues

The ENP seeks to improve the transport infrastructure connecting the enlarged Union with neighbouring countries, to develop the information society (in keeping with the Lisbon Agenda), to include the neighbouring countries in the EU's research area, and to promote good environmental governance in neighbouring countries. This is particularly important in the case of river and other ecosystems that overlap the EU's new eastern frontier, and in light of the new neighbours' inexperience in effective trans-border environmental governance. For example, the Tisza river basin, which connects Hungary, Romania, Slovakia, Ukraine and the Union of Serbia and Montenegro, has well-preserved rural landscapes, vast complexes of natural forests, and important biodiversity resources. It also suffers from numerous pollution hotspots, declining heavy industry, lagging economic development, high unemployment levels, emerging patterns of regular flooding, and other tensions linked to the legacies of communism and problems of transition. The ENP could facilitate better trans-national management of the Tisza river basin.

The HIV/AIDS epidemic that is emerging in the Western CIS countries (particularly in Ukraine and Russia) – as well as in Estonia – is another serious cross-border challenge that is not addressed in the ENP. Prevalence rates by the end of 2001 in these countries were at about 1% of the adult populations – the level at which the epidemic began to spin out of control in some African countries. (By contrast, prevalence rates in Western Europe at the end of 2001 averaged 0.3%, and were below 0.1% in Central European countries[24]) UNAIDS estimated that some 1 million people were living with HIV in Russia at the end of 2003 and the virus continues to spread rapidly in Belarus and Moldova. In addition to the high prevalence rates already recorded in Estonia, there is evidence that HIV incidence is also growing rapidly in Latvia and Lithuania[25]. HIV/AIDS trends are trans-boundary and the enlarged EU cannot avoid facing this problem. Instead, it should promote the same values and reforms that helped the new member states to effectively respond to the HIV/AIDS epidemic. These include democratisation, the modernisation of state structures, and the empowerment of individuals and NGOs, which have promoted the good governance and the grass roots social and behavioural changes needed to combat the epidemic.

4.3. Governance

The ENP could help to strengthen political dialogue in the areas of security, conflict prevention and crisis management, border management, migration, visa policies, and organised crime. The ENP offers a possible framework for greater international involvement in Moldova's Transnistria. Likewise, the inclusion of Armenia, Azerbaijan, and Georgia in the ENP could increase the EU's role in the potential resolution of the disputes in the Caucasus.

In addition to political stability, institutional capacity is key to development. The new neighbours still face major challenges in modernising state institutions, particularly in terms of decentralisation and public administration reform. Imperfections in governance in turn prevent the emergence of the market friendly

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[24] UNDP. (2004).

[25] Ibid.

state structures needed for improved business and investment climates. Major obstacles are associated with taxation systems and high corruption levels (cf. Table 1), which generate large informal sectors.

Table 1. Corruption Perceptions Index*

	1998	1999	2000	2001	2002	2003
Albania		2.3			2.5	2.5
Bosnia and Herzegovina						3.3
Croatia		2.7	3.7	3.9	3.8	3.7
FYR Macedonia		3.3				2.3
Serbia and Montenegro	3.0	2.0	1.3			2.3
Armenia		2.5	2.5			3.0
Azerbaijan		1.7	1.5	2.0	2.0	1.8
Georgia		2.3			2.4	1.8
Belarus	3.9	3.4	4.1		4.8	4.2
Moldova		2.6	2.6	3.1	2.1	2.4
Russian Federation	2.4	2.4	2.1	2.3	2.7	2.7
Ukraine	2.8	2.6	1.5	2.1	2.4	2.3
Bulgaria	2.9	3.3	3.5	3.9	4.0	3.9
Romania	3.0	3.3	2.9	2.8	2.6	2.8

* Measures perceptions of the degree of corruption as seen by business people, academics and risk analysts. The measure ranges between 10 (highly clean) and 0 (highly corrupt).
Source: Transparency International, www.transparency.org/cpi.

Migration, which can be a key engine of European growth, is now receiving growing attention in the European Union. Some studies have found that immigrants in the US produce 4.5 times more in the US than in their country of origin with the same skill level. They benefit from extra and more advanced physical capital and capable institutions that allow them to perform at higher levels of productivity[26]. Remittances from migrants can contribute to development in the home country if they are used locally to start-up small enterprises without providing long-term finances[27]. Remittances also make major positive contributions to the balance of payments in virtually all the new neighbour and West Balkan countries, rivalling (if not exceeding) levels of official development assistance (and in some cases FDI).

5 Conclusion

The impact of the European Neighbourhood Policy will ultimately depend on its influence on economic development in the new neighbours. So far, it is easier to find reasons for scepticism than optimism. Although the ENP seeks to ease trade restrictions through the implementation of legislative approximation and convergence with EU standards, prospects of access to the EU's single market seem rather far away. The same would therefore apply to the FDI needed to transform the economies of the Western CIS and the Caucasus. The lack of measures to promote increased labour migration between the new neighbours and the enlarged EU may also be something of a missed opportunity. On the plus side, access to the single

[26] Klein, M. (2003).
[27] Ellerman, D. (2004).

market could improve significantly under the ENP. Likewise, the new European Neighbourhood Instrument can add more coherence in technical assistance, and provide more financial support for creating capacities for trade infrastructures and institutional and private sector development.

Whether these benefits will be sufficient to push recalcitrant reformers to adopt robustly European policy agendas remains to be seen. Government interest in reforms seems likely to depend largely on eventual prospects for EU membership. The ENP does little to remove fears in this respect. Indeed, its emerging role as substitute for EU membership could make the ENP ineffective–if not counterproductive. It is not clear that the countries of the Western CIS and the Caucasus will be motivated by prospects of an eventual stake in the single market, or of some easing of visa restrictions.

Fundamentally, the neighbourhood policy has yet to show what it is meant to be. It could be a modest mechanism for mitigating the unfavourable effects of the enlargement for border regions. It could also be an attempt to motivate a serious 'Europeanisation', in the sense of political, economic and societal transformation of neighbouring states. As one observer noted: 'the optimist can say that this is a case of a glass half full, rather than half empty. At least the glass has been constructed, it is reasonably transparent, and more can be poured into the container in due course'[28].

[28] Emerson, M. (2004).

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