Tibor Palánkai

Theoretical relevances of our integration maturity

Integration theories generally analyse five major dimensions of the process, namely, the following:

- the contents (essence) of integration processes;
- fundamental organisational forms and institutions of integration;
- integration policies (regulation), issues of governance;
- benefits and drawbacks of integration;
- integration maturity (integration capacities).

For a long time, the literature of integration assigned key importance to the forms of integration and the cost-benefit analysis for practical reasons. With the progress and completion of the integration process, however, issues of governance also assumed a growing need for a solution. With regard to the development of the single market and the economic union, as well as the eastern enlargement, the issue of integration maturity has also been added to the agenda starting from the 1990s.

Earlier, it was possible to ignore preparedness for integration (at the level of free trade agreements, the customs union and the single market) for a number of reasons. Particularly in the first period, the economic development and structure of countries entering the integration were basically similar, and all were deemed to be mature for integration. For the enlargement performed in the 1980s, political considerations were clearly dominant. What is more, the Copenhagen criteria are also the fruit of a political bargain, considering that at the time the associated eastern countries endeavoured to achieve acceptance of a possible membership in 1992 with the EU member states, it was precisely the criteria they raised in an attempt to reach a compromise.

The programme of the economic and monetary union made it clear, however, that at this level integration maturity could no more be ignored on political grounds. A significant new circumstance for the economic union was the fact that member countries were not automatically allowed to participate; they were required to meet certain criteria. The consequences of market liberalisation were mostly unilateral and unidirectional (less developed or weaker partners had more to lose), and the responses to wealthier and stronger member countries were not directly experienced. The situation with the single market and particularly with the economic union was different: interactions were amplified and became direct. Economic difficulties of a partner (budgetary deficit or regional imbalances) affect the economies of the others, and may destabilize them (for example by generating inflation). Participation in the economic union also has an effect on the

institutional and political structure of the respective national economy. In this context, readiness and preparedness for integration need deliberation.

On the other hand, integration maturity was raised in connection with the different development levels of member states, and new applicants in particular, and it was especially marked on adding eastern enlargements to the agenda.

It is natural that each integration organisation may specify certain conditions for membership to the participants. These are mostly obvious (resulting from geographical closeness or political orientation), or are general enough not to be exclusionary in nature. The Treaty of Rome only stipulated for participation in the European Communities that the country in question be European and democratic. Although it left some uncertainties in terms of geographical definition (for Turkey, for example), it was general enough to open up a possibility of accession as wide as possible. In other cases, the social and political orientation of countries was decisive (for instance, the Council of Mutual Economic Assistance). The necessity of formalizing accession criteria became obvious in the context of eastern enlargements.

From 1948 (foundation of GATT) until 2000, 214 regional trade agreements were concluded among the countries of the world. Out of these, only 134 were still in effect by the beginning of the 2000s. The majority failed: they either terminated activity or were cancelled. This is particularly true for agreements concluded in the first wave of regionalism, which mostly disappeared after the great political and economic changes of the past decades (the economic crisis of 1970s, or the collapse of the Soviet block). The second wave starting from 1990s appears to be much more successful, when the creation of new organisations were urged by increasing international economic interdependence and the progress in communication (Jones, R. A. 2001, p. 28) As many as 90 such new regional trade agreements were concluded between 1995 and 2000 only – from the free trade zone to the common market.

It is obvious that this high "casualty rate" was an outcome of numerous specific economic and political factors. This large number may also suggest more general and fundamental reasons, but it also raises the question of how well general conditions were provided, and how prepared the specific countries were to apply the particular forms of regional integration. In other words: the question is how mature these countries or regions were for integration.

We started dealing with integration maturity under multiple research programmes at the Global Economics department of Budapest Corvinus University (Budapest University of Economics (Közgazdaságtudományi Egyetem) at that time) in the early 1990s. During the research, it became apparent that distinctions must be made between meeting accession or membership criteria and integration maturity due to the complexity of preparation for and participation in regional integrations.

Accession or membership criteria, in a broad sense, define the conditions and requirements of participation in an organisation of integration, both formally and officially. Accession criteria are narrower; they refer to a specific integration organisation or form, and specify no more than the conditions of becoming a member. Accession criteria must be met previously, from the outside. Non-compliance can simply be sanctioned by delayed admission.

Membership criteria are applicable to the requirements for behaviours and actions within the integration zone, they are met from the inside, and non-compliance is sanctioned (court enforcement of compliance with the rules of the single market; procedures stipulated for non-compliance with the Growth and Stability Pact or meeting democratic principles, or sections 6 and 7 of the Treaties of Amsterdam and Nice).

Broadly speaking, adoption of and compliance with the entire *acquis communautaire* is a membership criterion in the European Union.

Accession criteria are dependent on the level of integration the given organisation has reached by the time of accession. When Greece or Portugal acceded, they entered a common market structure. New members now accede the single market and the economic and monetary union. They are required to meet some of the membership criteria still before accession, while some gradually, from the inside.

Integration maturity can be defined as a capability to exploit the benefits of the given form of integration to the maximum, while the costs and drawbacks can be minimised. Integration maturity can be measured by comparing costs and benefits. A country is mature for integration if membership on the whole is advantageous for it.

An analysis of integration maturity does not primarily focus on compliance with conditions and requirements, but much more on the consequences and successfulness of the process. These two are certainly closely related, considering that membership criteria endeavour to express integration maturity. Accession and membership criteria specify a minimum of requirements instead, which may allow accession on compliance, while the issue of maturity goes far beyond that, and generally examines the conditions of successful and efficient integration in their entirety.

In the EC/EU, specific accession criteria were defined first in 1991, pertaining to the transition to the economic and monetary union. The so-called Maastricht convergence criteria grab an important requirement of the monetary integration when requiring member countries to meet specific indicators of monetary and fiscal stability as a condition to participate in the EMU.

▫ Member countries need to achieve a high level of price stability. Inflation as measured by the consumer price index cannot vary more than 1.5 percentage points from a standard set by the three member states achieving the best inflation results in the examined one-year period.

▫ Government financial positions need to be stable, specifically:

- budgetary deficit should not exceed 3 per cent of the GDP, and
- state debt should be under 60 per cent of the GDP.

▫ Convergence in terms of interest rates is construed for the average nominal interest rate of long-term government bonds not to vary more than 2 per cent from the results measured in the three countries with the best results in price stability in the examined years.

▫ The member country's currency should participate in the EMU's exchange rate mechanism, and within two years be stable to an extent not to have to be devaluated against any country's currency.

Accession criteria related to eastern enlargements have been defined for new admittees. The so-called Copenhagen criteria were accepted in June 1993, then further specified and completed. These conditions are as follows:

- stability of democracy, of legitimity and of institutions that guarantee human and minority rights;
- a market economy that is operational and able to withstand the pressure of the acute competition typical of the EU and of market forces;
- compliance with obligations pertaining to membership, and acceptance of the goal of the political, economic and monetary union;
- availability of the EU's absorption capacity.

Parameters of compliance with accession/ membership criteria are in some cases precisely elaborated and explicit (for example, the Maastricht convergence criteria). In other cases, parameters needed for analysis and assessment are rough, inconsistent, highly dis-

putable or simply missing. No material guidelines are available for the Copenhagen criteria, for instance. This is often traced back to insufficient elaboration of analysis methods, while at other times it is also a sign of deliberation, which provides a facility either to manage conditions in a flexible way, or to accelerate or delay and hinder the integration process.

The maturity and preparedness of acceding countries for membership were examined by the European Commission and other EU organisations (for example, the European Parliament) on a regular basis, fundamentally from the aspect of meeting the accession criteria, of course. These provide no serious theoretical and methodological foundation for the assessment of integration maturity. Their system of criteria and methods of analysis are unclear, and provide but a loose framework for assessment on political grounds.

It is not only on accession that the examination of integration maturity is necessary and timely, given that the maintenance of integration capabilities constantly remains a condition of reaping the benefits subsequently. The case with accession criteria is slightly different. Examination of these loses significance after the accession, as member countries are never excluded, not even on non-compliance. Countries are called to account for compliance with the accession criteria (for example, based on the Stability and Growth Pact) on a continuous basis; what is more, non-compliance is (or may be) sanctioned.

Integration maturity can be analysed in terms of four main dimensions: compliance with

- economic,
- social,
- political and
- institutional aspects and criteria.

A particularity of the Copenhagen accession criteria is that they equally stipulate political, economic and institutional conditions for new members. However, a characteristic of the Maastricht decisions is that they are narrowed down to budgetary and monetary criteria within economic ones pertaining to accession, although institutional requirements are also stipulated as a membership criterion. Beyond the Stability and Growth Pact, regulation of the independence of national central banks and the European Central Bank also refers to this. (Social implications of integration maturity are not addressed here.)

ECONOMIC CRITERIA FOR ACCESSION AND MEMBERSHIP, AND INTEGRATION MATURITY

Basic criteria of integration maturity concerning the economics of integration are as follows:

- operational market economy;
- competitiveness (structural and development requirements);
- macroeconomic stabilisation/stability;
- convergence;
- capability of being financed and providing financing.

The parameters of integration maturity are more complex than the ones generally used for accession and membership criteria. These criteria constitute the general frameworks for normal operation of the given form of integration; these form the conditions of successful integration. It is expedient to analyse economic criteria as broadly as possible, given that the profitability of this enlargement, as well as the maximum utilisation of the benefits in terms of efficiency and well-being fundamentally depends on the compliance with these.

On the market economic criteria of integration

In Copenhagen, establishment of an operational economy that is able to withstand the pressure of the acute competition typical of the

EU and of market forces was set as a condition for accession. Normal operation of the market economy is a starting condition for all forms of integration. The whole theoretical and analytical system of the economics of integration is based on assuming these. Liberalization eliminates precisely the obstacles to these in terms of trade or economic policy. The advantages of internal free trade can only be utilised alongside properly operating market mechanisms. The issue of an operational market economy was only added to the agenda as an official membership criterion pertaining to the accession of Central and Eastern European countries; however, it does not mean that it had no relevance earlier. At the same time, it is obvious that this issue is assigned various emphases at the various levels of integration, and cannot be avoided in case of closer forms of integration (EMU), not even for the most developed countries. It is a different question that the requirement of an operating market economy (flexible factor markets and factor prices) was not set as a membership criterion for the EMU, either, but was only analysed in informal theoretical debates.

The six founding countries of the European Economic Community, as developed market economies met this requirement, and material doubts of this type did not arise even for Mediterranean enlargements. (As opposed to eastern enlargements, Greece, Portugal and Spain only acceded the common market.) They were compliant, at least practically, if we consider that no market economy operates perfectly. It must be added that this compliance was not full or automatic at all. It is no accident that the customs union and the common market have been coupled with powerful competition control and regulation at a community level right from the beginning, to which broad legal harmonisation ensuring unhindered trade has been added subsequently. A number of measures facilitate becoming an operational market economy. For the members of the EC, it was sufficient to perform it after being admitted as members.

Similarly, member countries have adapted themselves to the single market from the inside and subsequently since the early 1990s. Formally, the single market is a step forward compared to the common market, i.e. a more developed grade of integration. At the same time, in terms of contents, it is no other than the actual implementation of the common market. The common market also identifies the four freedoms as an objective, but it mostly focuses on eliminating the limitations to it. The programme of the single market tries to break down all the limitations to the four freedoms systematically, thus ultimately creating the conditions of an operational market economy.

Applying a theoretical approach, certain similarities may be revealed between an optimal currency zone and the Copenhagen membership criteria. The optimal currency zone also raises the requirement of an operational market economy, even if applicable mostly to the factor markets, specifically. Given that the single market is a starting condition to the economic and monetary union, an operational market economy in this case still covers a much broader criterion. “In economic terms, the EU maturity of a country can ultimately be also conceived as a capability of seamless adaptation to the single market.” (Rácz, M. 2000, p. 812) We could also say that an operational market economy is the most general criterion of integration, and an important condition for properly exploiting the benefits of integration.

On the eastern enlargement, the issue of integration maturity emerged as a novelty. Central and Eastern European countries in the early 1990s were still in the middle of the transition, and what was formulated in June 1993 in Copenhagen as an accession criterion was practically no other than the completion of transition from a centrally planned economy to a

market economy. Concerning central and eastern Europe, adoption of the requirement of an operational market economy set a certain desired minimum of transition on the one hand, and bore a reference to the requirements of participating in the single market, on the other hand.

From the aspect of accession and membership maturity, an important issue is the proper construal, identification and, in certain cases, measuring of the operability of a market economy. It was obvious: the mere legal establishment of the institutions of a market economy was in fact insufficient for the candidate countries to meet the requirement for maturity.

Operability of the market economy is a natural expectation at any level of the economy. Operability assumes a free movement of market participants and prices without any artificial constraints. Participants of the economy respond appropriately and rationally to market impacts in the given economic and economic policy environment. Company surplus becomes a profit in the actual sense of the word, which can be used to measure the contribution of the company to the profitability of the entire economy. Implementation of a market economy requires the application of policies, institutions and means of economic policy that are in harmony with the operation of the market, and attempt to harmonise broader social interests taking these into account (market-conform state institutions). Under the circumstances of globalisation – particularly in smaller economies – an important condition is for the economy to (be) open to external institutions.

Transition reports (for example, EBRD Transition Reports) in combination with the EU's Regular Reports on countries provided an assessment stating that the candidate Central and Eastern European countries – with Hungary among them – met the requirement of an operational market economy by the late 1990s. In Hungary, privatisation was mostly over (and involved corporate reorganisations unparalleled in the region), the major elements of the market economy came in line with the parameters typical of developed countries:

- approximately 97 per cent of prices are liberalized,
- entry to the free market is ensured,
- the majority of foreign trade (approximately 80 per cent) has become free,
- the forint has been convertible in terms of the current balance of payments since 1996 (and fully so since 2001),
- interest and exchange rates reflect market conditions.

Money and capital markets are rapidly expanding, with their services and infrastructure upgraded. The two main pillars of the market-conform tax system, the sales taxation in the form of value added tax adopted in 1988 and the progressive income taxation have been reinforced, and the Hungarian economy has performed successful modernisation since the mid-1990s. In the other countries, the value added tax was only adopted as of the 1990s. Economic legislation approached the EU standards, and has reached them in most areas. Similar developments have taken place in the Baltic states; however, Bulgaria and Romania have been unable to overcome their handicaps. The other countries in the region (the former Soviet and Yugoslavian republics) are lagging even more behind, although Croatia, for instance, may rapidly catch up.

We may have practical experience on integration maturity only a couple of years after achieving membership. However, the impacts of European Agreements implementing the free trade association have previously suggested that these countries are capable of exploiting the benefits of market integration. Full membership (full incorporation in the single market) did not pose a dramatically new situation in terms of opening the market (the market of

industrial products had already been liberalized), and opening in additional areas (the agrarian sector, services) may also result in a positive balance of benefits and drawbacks. Integration maturity at the same time also needs to be extended to the economic and monetary union, considering that the new members wish to accede to these after a relatively new transitional period (3 to 6 years).

Requirements for competitiveness (development and structure)

Requirements and criteria for competitiveness, development and structure already became the focus of attention related to the free trade zone as the loosest and simplest form of market integration (particularly in connection with the integration attempts of emerging countries), and the situation is all the more so with more developed basic forms.

Compared to earlier enlargements, the problem of differences in development and structure emerged particularly strongly on eastern enlargements. In some of the candidate countries, the weight of agriculture is still significant, and the competitiveness of multiple sectors is low. The requirement of withstanding the pressure of competition was the manifestation of a very realistic concern. It expressed the fear – justified to some extent in 1993 – that membership may also have serious, what is more, disastrous effects on the economies of the candidates, which was not the interest of either party.

The EU did not detail the parameters of withstanding the pressure of competition, which left it wide open to interpretation. We believe that the EU only defined competitiveness as a membership criterion indirectly and with a narrowed meaning (for example, exchange rate stability). At the same time, competitiveness must be considered an important indicator (probably one of the most important ones) of integration maturity. No doubt, the candidate countries are unable to exploit the benefits of integration unless they have companies and products capable of withstanding market competition. Otherwise, competition may eliminate the companies of acceding countries from the market in large numbers.

Competitiveness, however, is not a clear-cut concept (and even less measurable). Although some believe that it can only be understood at the level of products and companies (cost level, product quality, etc.), and cannot be interpreted at the macro level, competitiveness needs to be analysed in a complex way. Micro and macro approaches are both relevant, but it is not simply a case of adding up producers' and companies' competitiveness at a national or international level, they have independent factors and effect mechanisms.

Countries do not only compete by their structures of production, technical and economic management (products, technologies, innovations, corporate governance) or the development of their infrastructure, but also by their social, economic and institutional systems. And, in a given situation, the latter may be more important. It is well known, for example, that the processing industry of the most developed EU member states has no material disadvantage compared to their global rivals in terms of production and technological competitiveness. Their structural problems are mostly related to social and institutional factors (overregulation of economies by the state, lower efficiency of the state sector, high taxes, the crisis of the European welfare state, inflexibility of factor markets, etc.). Reinforcement of the EU's competitiveness is much more dependent on implementing structural reforms than on product or technological development in a traditional sense.

In terms of integration maturity, the technical/structural, performance, infrastructural,

institutional and political, as well as the subjective dimensions of competitiveness are the most important ones.

Various analyses clearly suggest that the competitiveness of new members in terms of accession and integration maturity has significantly improved in the past decade. Central and Eastern European countries have made material progress in competitiveness rankings, and have fought their way up to the mid-field of global world economy. In terms of the general competitiveness index of the World Economic Forum, Hungary ranked 26th in 2001 (32nd in 2000), and first in the region. These analyses indicate that new Central European members may stand a good chance of catching up with the developed centre of the EU in 15 to 20 years.

Unfortunately, the positions of Hungary have gradually deteriorated in the past years, according to the World Economic Forum's ranking, and, based on 2004 data, have gone back to the 39th position (and stayed there also in 2005 and 2006). Considering that three new countries were added to the study in the meantime, Hungary went down in ranking 10 positions only. This weakening position can basically be traced back to the macroeconomic performance (particularly to the record deficit of the central budget).

The main source of competitiveness of the Central and Eastern European economies lies in a rapid improvement in their productivity, as well as the high quality and inexpensiveness of their human capital. The competitiveness of Hungarian goods is principally rooted in these. As established by ITDH's study entitled Competitiveness 2000, productivity calculated using the production per employee in the processing industry between 1991 and 2000 grew to 2.2 times the rate. As opposed to this, real wages increased moderately, by approximately 20 per cent in total, with certain fluctuations. Considering this, the competitiveness of the Hungarian industry rose significantly, and wage cost advantages increased. The transformation crisis went hand in hand with a material cut in real wages, which only started rising in the second half of the 1990s. Between 1997 and 2000, real wages in Hungary grew by 3.1 per cent per year, with a 4.7 per cent annual increase in productivity – i.e. wage cost advantages carried on improving. (*Napi Világgazdaság [Daily World Economy], 27 July 2001)* Some data reveal that while Hungary's general productivity level is 58 per cent of the EU average, the wages are only around 40 per cent of the same. (*Consulting 2002 – Világgazdaság [World Economy], 15 February 2002)* The fact that real wages grew by nearly 40 per cent – a rate far above the growth rate of competitiveness – between 2001 and 2006 has weakened the country's competitiveness.

As a result of market liberalisation, energy prices in Hungary are practically in line with the world economy averages. For electricity and gas service, the state has kept retail prices lower, but industrial consumption prices are close to the level of those in other EU member states. The expensiveness of telecommunications, however, represents a competitive disadvantage. Calculated at purchasing power parity, the business sector phone costs are 30–40 per cent higher compared to the developed countries. Costs of Internet access are 2 to 3 times of the EU rate. Although real evaluation of the national currencies in the majority of Central and Eastern European countries has kept a curb on improving competitiveness, but it caused no problems in the long run, considering that productivity grew faster.

Despite the relatively good quality of labour force, the new members are still far from establishing a knowledge-based society. In the majority of countries, and also in Hungary, the main losers in the transition crisis were R & D expenses, their share in the GDP decreased to 0.5 per cent from the 2 per cent measured in the early 1990s. Although convergence has started

in this area, too, the Hungarian rate of approx. 1 per cent is still behind the EU's 1.8 per cent rate. The entire EU is also lagging behind its global competitors. (The same rate in the USA is 2.8 per cent, and 2.9 per cent in Japan.)

The rapid growth of productivity is still of key importance, and much difference is made by how fast and successfully these countries can enter the knowledge-based society. An encouraging sign is that transnational companies in Central and Eastern Europe have made increasing investments in the R & D sector. As calculated by the OECD, the processing industry and one quarter of services output originate from knowledge-based sectors in Hungary, and it is a higher rate than in numerous leading countries (Germany, France or Austria). In this respect, the Czech Republic and Poland precede Portugal. *(Financial Times, 28 October 2001)*. Transnational corporate structures represent the basis of the country's competitiveness. At the same time, the structure of the Hungarian economy is of dual character. The competitiveness of domestic small and medium-sized enterprises is far from satisfactory.

The competitiveness of the region is weakened by a relatively high level of social redistribution. Although the tax rate of 39 per cent as a percentage of GDP in Hungary is below the 42 per cent EU average (this number in the USA was 30 per cent, and 27 per cent in Japan), but comparison with countries like Portugal (34 per cent) or Ireland (31 per cent) is more justified, considering its relative development. In 2000, the respective data for the Czech Republic was also 39 per cent, while 36 per cent for Slovakia and 34 per cent for Poland. "To be able to stand its ground in the expected stronger competition on the European Union's extensive market, Hungary should have reduced its level of tax burden by a minimum of 4–5 percentage points back before the accession, performed in a single step, which – depending on the future steps of the other countries in the same group – should be followed up by further adjustments in certain cases." (Szabó, 2004, p. 39)

Macroeconomic stabilization and stability

Stability of an economy is no doubt an important factor in integration maturity. This is valid for both normal market operation and the utilisation of market integration benefits. Certainly, macroeconomic stability and successful integration are mutually dependent on each other: stability may be a prerequisite to integration, on the one hand, and an indicator of its success, on the other hand.

We have a number of possibilities to measure stabilisation, and selection among these is possible considering, for instance, the priorities set in the stabilization process. Generally, it would be difficult to find measures or parameters that are valid in an absolute sense, and which could be used reliably to characterise the stability of a country's economy or the optimal nature of its stabilization process. Reference points are mostly relative, and express stability comparative to specified considerations. Based on such indicators, an attempt can be made to calculate stability indices or forecast crisis situations on the basis of unfavourable processes.

■ "Optimal or favourable macroeconomic performance, which is based on an ideal configuration of economic growth, inflation, employment or the budget balance. This is of course a very uncertain and relative approach. Presumably, the question can be best assessed on a case-by-case basis. Economic performance, and consequently, stability depend on a number of factors (level of development, innovation capacities or positions in world economy, etc.). For economic growth, output gap can be examined, which is the difference of growth potentials and actual growth." *(OECD*

Economic Outlook, November 2001, No. 70.) Economic growth can also be compared to the trend line of development (a theory of *Jánossy, Ferenc)*, which means that a 3 per cent growth for a certain country can be insufficient, while in another case a 2 per cent growth can be optimal and fairly satisfactory. Unemployment can be compared to its natural rate, which may show large differences by country, in terms of various factors. Inflation is considered satisfactory if the desirable inflation is within a 2–3.5 per cent band defined internationally. Generally, equilibrium between the central budget and the balance of payments is considered desirable, but this requirement cannot be absolutised, either. For countries that are rapidly modernising and changing their structures, a deficit in the budget and the balance of payments can probably be significant; still, it would not be expedient to consider it a sign of instability. Consequently, the indicators of good performance and economic stability need prudent and specific analysis. In certain cases, absolute performances should be used as the starting point, in other cases, an improving tendency of processes that at other times are sufficient for stability.

▪ Ensuring sustainable growth (which should not be mistaken for sustainable development, which strives for harmonising economic prosperity with sustaining, or what is more, improving the condition of the environment). This issue is particularly important for Hungary, which has been struggling in a particular stop-go cycle since the 1970s, resulting in over 20 years of economic stagnation. From time to time, economic growth has proved inconsistent with the balance of the economy, which has never allowed for growth rates over 1–2 per cent. Higher growth rates regularly and immediately lead to crashing the budget and the balance of payments, which resulted in a significant and unacceptable increase in debt stock. This is what happened in 1987 when a growth rate barely over 3 per cent lead to a doubled debt stock, but the case in 1993 was also similar. Restrictions made in favour of the balance regularly kept development back. The Hungarian economy was only able to break out of this ill-conceived cycle after 1997, owing to drastic stabilization measures in 1995 (the Bokros package) and successful modernisation of the economic structure. The Hungarian economy took to a sustainable growth path after 1997, and a relatively rapid economic growth (around 4–5 per cent) seemed sustainable in the longer term without causing external or internal imbalance. The economy gradually slipped off this path after 2001, and has not been able to return to it – at least in terms of budgetary balance. Sustainability of growth is also a manifestation of the structural state of the economy: so-called structural problems show a slow growth rate as a major symptom. A number of other countries (Bulgaria or the Czech Republic, for that matter) have also struggled with similar problems.

▪ Performance characteristics of economies, compared to the EU:

- choosing the economic performance of EU member states as a benchmark, what is more, using the indicators from the golden era (1957–1973) of economic development.
- comparison with the average performance of EU member states.
- the best performing EU countries can be used as the benchmark.
- EU member states at an almost similar level of development can be used as the basis of comparison.
- the Maastricht criteria can be used as a starting point, which can be topped off with compliance with the Stability and Growth Pact.

After the planned economies crashed, Central and Eastern European countries experienced a grave transformation crisis: they were

forced to modernise their economic structure in a radical way, while their economic output was deteriorating apace starting from the late 1980s. The depth, scale and consequences of the crisis were comparable to nothing but the Great Depression of 1929–33 in the 20th century. Between 1989 and 1994, the GDP in Hungary decreased by approximately 20 per cent, while unemployment and inflation peaked at 12.4 per cent in 1992 and 38 per cent in 1991, respectively. Hungary, as well as all countries except for the Czech Republic and Slovakia (the Czechslovakian peak of inflation was 58 per cent in 1991) faced hyper-inflation – at around 1000 per cent – by the early 1990s, while unemployment peaks in most of these countries (Slovakia, Poland, Slovenia, Bulgaria, Romania) reached 15–17 per cent.

The transition crisis affected Central and Eastern European countries less than the rest of the former socialist countries, and they started emerging from it as early as after 1993/94. The upsurge was rooted in an external economic opening, the extension of trade with chiefly EU member states, and the influx of foreign working capital, which, in most countries, was coupled with a structural reorganisation of the economy. These countries reached their production level of 1989/90 around 2000, and then gradually entered a period of convergence. The decline of other countries or regions (the Balkans, the Baltic states, the CIS, etc.) was larger in scale, and it was also a longer time until a boom set in.

The GDP in Hungary reached the level of 1989 in 2000, and even exceeded it by 31 per cent by 2006. Economic growth caused a stronger upswing starting from 1996, and the annual growth between 1997 and 2001 reached 4.5 per cent. In 2002/2003, growth slowed down to 3.6 per cent, and then, the average of the years 2004 to 2006 rose again to approx. 4.2 per cent. Global recession has moderately affected the economy, and the extra growth compared to the EU has remained a permanent 2.5 per cent since 2001 (i.e. slow-down in the EU was more intensive). The growth structure deteriorated between 2001 and 2003: while investments were declining, consumption grew intensely. The unemployment rate in Hungary (7 per cent in 2005) is relatively favourable in the region; however, the employment rate stays behind the level of 1990. (It was 4.9 million in 1990, and reached its low point at 3.6 million in 1997, but even in 2005, it was only 3.9 million.) The activity rate is around 55 per cent, which falls behind the 62 per cent average of the EU. Particularly after 1995, inflation decreased gradually, but it only broke through the 10 per cent rate – from above – as of 1999. Inflation decreased to 3.6 per cent in 2005, but the stabilization measures of 2006 may induce another acceleration, and the planned 2.5 per cent does not seem feasible.

Despite its relatively good general stabilization performance and integration maturity, Hungary shows a significant lag in terms of compliance with the Maastricht criteria, what is more, occupies the penultimate position among the new member states. Particularly unfortunate is the budgetary deficit. The record amount of budgetary deficit in 1995 (8.1 per cent) decreased to 3 per cent by 2000, and then deteriorated intensively (in 2002, and it broke another record of 8.4 per cent). Efforts made to improve the balance brought but moderate results, and by mid-year, the 4.7 per cent deficit projected for 2006 turned out to be unfeasible, and potentially to reach a rate of 9.6 per cent in the absence of stabilization measures. State debt in 1993 equalled 91 per cent of the GDP, but it decreased to 52 per cent until 2001, and rose above 58 per cent by 2005. In 2006, it may reach 62 per cent, which would cause Hungary (the only one of the new member states) to exceed the Maastricht ceiling.

As the Commission established in Agenda 2000, convergence criteria will be key bench-

marks from the aspect of assessing stabilisation-oriented macroeconomic policies, and when the time comes, the new member states will have to be in permanent compliance with these. (Agenda 2000, The opinion of European Commission on Hungary's Application for EU Membership. *Integration Secretariat of Foreign Ministry of Hungary, 1997, p. 41)* As the macro performance of the new members has been relatively favourable in the past years, shortcomings of stabilisation have not hindered accession. (The performance of the old leading member states has also deteriorated to such an extent that they could not have used Hungary's lag as a reference.) A separate issue is accession to the Euro zone, or the permanent macroeconomic stability that constitutes a prerequisite to it. This in the next years will depend on consistent implementation of structural reforms, successful structural modernisation and sustainable growth ensured. As of 2007, Slovenia may join the Euro zone, and soon after that the Baltic states may follow. Officially, the Visegrad countries hope to adopt the Euro starting from 2009 (Slovakia) and 2010. Based on current performances, an adoption in 2011 seems more realistic for Hungary.

Real economic and financial convergence

Convergence may be examined from both real economy and monetary aspects, and in a certain respect, is a necessary prerequisite to efficient and successful integration. Variance in development standards and integration maturity are only very loosely connected. Balanced development cannot be considered a prerequisite, but benefits may be distributed very unevenly in case of major differences. The ideal case is an almost identical level of development, but this only characterised the European integration back in the fist period. The majority of integration programmes identify levelled development as a desirable and official target, and the EU strives to facilitate achievement of this using common policies.

In case of extreme differences, it is very probable that the balance of benefits and drawbacks is negative for a less developed country, i.e. the country in question is not mature for integration, and for this reason, integration is not recommended for it. For larger differences of development, looser forms of integration (free trade associations) are recommended, and it is expedient to link these to certain forms of compensation. Compensation may take place through asymmetric trade liberalization, financial aids or technical and other types of assistance. These may offset one-sided benefits, may adjust relationship and structural distortions, and may render conclusion of such contracts mutually acceptable. Later, as convergence progresses, compensations may be eliminated.

When the six countries signed the Treaty of Rome, their level of development and economic structures were very similar, with differences limited to certain regions only (southern Italy). Later, with consecutive enlargements – especially with the accession of Mediterranean countries – differences of development grew. The development level of these countries was 40–45 per cent lower than the Community average. Their accession – although with varying success – accelerated their economic development, and they achieved a remarkable level of convergence with more developed member states in less than two decades.

With eastern enlargements, a radically new situation evolved. The average difference of development standards has been increasing to a great extent (from an average of 20–30 per cent to 60–70 per cent), and the order of magnitude of the differences between the two extremes (Latvia or Lithuania and Denmark) reaches four-fold (and five-fold for Bulgaria). In the meantime, the development level of the most developed new

member countries and less developed old ones is practically identical. Accordingly, new members constitute a rather heterogeneous group, not only in terms of economic and social development, but also historical and cultural traditions. With the eastern enlargement, the ratio of population holding an income lower than the EU average grew by 77 per cent.

For the economic and monetary union, convergence is a more sensitive issue. Stronger integration may deepen economic and social differences (mainly regionally), and for this reason, budgetary transfers may be necessary under the issue of cohesion. Compliance with the monetary and budgetary convergence (the Maastricht criteria) is a prerequisite of a stable monetary union, particularly in terms of achieving price stability.

The extended structural, then transition crisis of central planned economies had a significant impact on their convergence. Hungary's GDP per capita in the 1960s is estimated to have been around 60 per cent of the European average, which at that time corresponded to the Spanish or Irish standard, and was well above the Greek and the Portuguese development. The world economic crisis after 1973 affected the countries of the continent to different degrees. The convergence of Ireland, Spain, Portugal and Greece accelerated particularly from the 1980s – as a result of the EU membership, among others. For the Central and Eastern European region, lost decades followed starting in the 1970s, when their relative situation deteriorated significantly. The twist for Hungary began after 1996, and in 10 years the country produced a remarkable performance in terms of convergence. Compared to the GDP per capita of the 25 (at purchasing power parity) the Hungarian indicator rose from 48.5 per cent to 61.5 per cent, and it may be ascertained that it reached a relative level of the 1970s. At the same time, it remained behind that of the Mediterranean partners, not to mention Ireland. If the country is able to keep the current extra growth of 2–2.5 per cent, our convergence with the EU average may be completed in 15–20 years.

In the past years, a number of institutions and banks have commenced publishing convergence indicators. Deutsche Bank Research publishes its convergence report for all new member states and acceding states once every six months. The convergence matrix is compiled from five indicator group, which is based on a summary of 16 variables. These indicators embrace

- real economy (GDP per capita, employment, the proportion of private economy in the GDP production, the weight of agriculture and industry),
- growth dynamics (growth of GDP and productivity),
- legal, institutional and regulatory elements (legal system, liberalisation index, banking systems, harmonisation of rates and policies),
- external factors (current balance of payments, influx of foreign capital, the proportion of trade with other EU member states in their foreign trade), as well as
- the situation of finances and the budget (inflation, budgetary balance and state debt).

Taking the 15 earlier EU members states as 100, the first group of new members is situated around the level of 75 (Slovenia, the Czech Republic, Hungary, Estonia), the second level approaches the two-third level (Latvia, Slovakia, Lithuania and Poland), while the two Balkan candidates (Bulgaria and Romania) are below 60 per cent.

The indicators of Spain and Portugal similarly around 75 per cent evidence that less developed earlier members and the most developed new members are practically at the same level and in the same category. (Ranking within the groups makes almost no sense, considering the differences are as low as 1–2 per cent as shown by specific data, consequently far below the fault limit.)

On examining convergence, differences in incomes per capita are often focussed on. A major merit of convergence indicators is that they evaluate the convergence process on a comprehensive and all-round basis – and precisely for this reason, they sometimes yield radically different results than simple income details. In respect of real GDP per capita (even at purchasing power parity) Hungary has only got as far as 61.5 per cent of the EU average, far below the Portuguese level. However, compared to complex convergence indicators, Hungary reaches 75 per cent of the EU average, and is level with Portugal.

Attention must be called in particular to the structural convergence of the Hungarian economy. Although the transition crisis, as mentioned previously, was combined with a strong recession in production, the structure of economy has radically changed in the meantime, and was approaching the economic structure of developed EU counties.

Between 1989 and 2004 in Hungary, the proportion of agriculture in producing the GDP decreased from 16 per cent to approximately 4 per cent, i.e. to one quarter. As opposed to that, the ratio of services grew from 42 to 67.5 per cent, which is over a time and a half. Similar tendencies have characterised other Central and Eastern European countries, too. The contribution of agriculture to the GDP in the new member states fell to 3–4 per cent by the early 2000s, which is still roughly twice the 2 per cent level of the fifteen EU countries, but the difference is more quantitative than qualitative. In the EU, services constitute three quarters of the GDP. Some new member states have reached or approached this level, but for the majority, this ratio is still around two thirds. Again, differences are rather quantitative than qualitative.

The ratios of trade between new member states and the EU suggest a high level of structural convergence, as does the strong similarity of their import and export structures, the rapid expansion of intra-sector trade and the shares of foreign capital. As for the ratios, material variances are only shown by the data of Bulgaria and Romania. Averages may cover large differences in our case, as well. The convergence of fine structures takes a longer time.

Providing financing and the capability of being financed

Convergence in terms of the development levels and structures of the economy necessitates serious developments, which requires significant resources. Similarly, the issue of compensation provided to the weak and the losers is raised, due to an uneven distribution of trade benefits. Tensions and confusions generated from growing differences is not in the interest of more developed partners, either; consequently, some form of solidarity and compensation has been on the agenda right from the beginning in the various integrated communities, what is more, the majority of integration organisations have assumed political obligations to equalise these.

Although no material differences in structure and development were present among the six founding countries of the EEC, they even made efforts to diminish the existing ones. What else could have been the purpose of introducing a common agrarian policy as of the 1960s than a compensation of the more agrarian France and Italy against a more industrialised Germany?

It is another question that the financing criteria for greater differences in development may be put on the agenda even related to the free trade agreements or the customs union. Later, as a consequence of enlargements, this is precisely what happened when the issue of regional supports came into focus with the growth of differences in development. Such supports had been primarily targeted at Southern Italy previously, but with the enlarge-

ments, supports had to be extended to additional regions. One reason for establishing the European Regional Development Fund (1974) was the Irish and English accession, as these countries (have) had a number of underdeveloped regions. With the Mediterranean enlargement, the problem has become more marked. The single market followed by the economic and monetary union has even more reinforced the necessity of a regional equalisation.

With the accession of the Central and Eastern European countries, differences in terms of economic development and structure have significantly intensified in the European Union; accordingly, the issue of providing financing and the capability of being financed are among the critical issues of enlargement. The capability of being financed is basically in issue of integration maturity, and an important indicator of it.

- Availability of domestic capital resources. How capable is the economy in question of producing the resources of its own development? This, among others, points out the relation between national capital accumulation and efficiency. With an obsolete economic structure and deficit-producing sectors, the options of internal savings also become restricted.
- The existence of operating capital markets, which are able to mobilise internal and external resources, and allocate resources reasonably. The economy's ability to minimise capital losses (devaluation of savings due to high inflation, freezing resources by way of thesauration, prestige consumption, transferring capital abroad).
- The state of budgets in the acceding countries, the ability of governments to reach or maintain a budgetary balance, and to fund the costs related to accession.
- The ability of a particular country to absorb capital, both in terms of external investments of private capital and the intake of budgetary transfers.

On the EU's part, at the same time, financing capability appears more as a membership criterion, which was also specified in the Copenhagen criteria, not explicitly, but indirectly. This means that it is not a question of whether the EU is able to finance the eastern enlargement, but whether the governments, and particularly, taxpayers are politically prepared for it. In Agenda 2000, the budgetary transfers defined as 1.0–1.5 per mill of the GDP were of a negligible order of magnitude, especially when considering that a significant part of these got back to the donor countries – in the form of orders. Still, the enlargement crisis of the past few years appeared primarily as a financing crisis (debates on the budget for 2007–2013, primarily on contributions by the member states).

Financing may equally serve the purposes of convergence and economic stability. As for external resources, convergence of Central and Eastern European countries certainly can also be basically implemented using foreign investments of private capital. For this reason, it may be assumed that integration entails an improving resource allocation this time, too.

In order to reach integration maturity and to implement a successful integration, the new member states need considerable resources for various reasons.

- A starting condition is to improve and maintain the competitiveness of their respective economies. The modernisation and structural reorganisation of the economies of new members have relied on foreign investments of private capital; consequently, their stimulation is of great importance. (Of course, the role of local private capital should not be neglected, either.)
- Development of the region's infrastructure. In this area, new members may rely on more significant EU funds – the majority of development costs, however, is left for the specific countries to pay (programmes implemented through co-financing or purely from the member state's resources).

- Improving the condition of the environment. Compliance with environmental requirements and expectations in the new member states would necessitate thousands of billions of Euros.
- Building institutions, harmonising legislation and policies.
- Compensating for losses. No doubt, adaptation to membership criteria involves costs, and certain sectors incur losses. This is a natural process, a part of the structural reorganisation related to integration. This, for instance, is expected in agriculture.
- Payment obligations to the European Union must be complied with.

Financing or being capable of receiving financing is a key issue of integration maturity and membership adaptation. Difficulties begin with the underdevelopment of capital markets and credit rating, which for a number of countries raise the expenses of involving external resources. In the worst case, rating may as well avert all kinds of reasonable investments, as it has occurred to a number of countries in the past 10–15 years. Still, a major limitation of eastern enlargements was budgets. It equally applies to the budgets of old and new members, as well as that of the European Union. Despite the restricted nature of the EU's financing capability, approximately HUF 1,000–1,100 billion is expected between 2007 and 2013 as annual supports. It is up to the country's ability to absorb supports and the reasonable application of funds how these resources are actually utilised.

POLITICAL AND INSTITUTIONAL CRITERIA OF ACCESSION AND MEMBERSHIP

In the political and institutional dimensions, compliance with membership criteria and integration maturity cannot be strictly separated. As for institutional compliance, it is more accurately the specific membership (accession) maturity that can be addressed. The questions of democracy can certainly be analysed in general theoretical contexts, too, and the general political state of integration may lead to conclusions to integration maturity.

Political criteria are related to political integration in a wider context, and it is particularly so if the integration community commits itself to a political union. Practically, this is only true for the EU alone out of the approximately 130 regional integration organisations in the world. For looser forms of integration, mostly no tighter political criteria are stipulated. At the same time, political expectations and conditions arise in connection with the free trade zone or the customs union, although these are restricted, and mostly of a legal and institutional nature.

This does not mean that political integration maturity is unconstruable. On the contrary: the general political contexts of this can be formulated very well in a number of respects. Political criteria can be important for looser forms of market integration. For instance, antimarket or anti-democratic political systems seriously endanger market operation (efficiency, interest, consumers' choice) or the freedom of enterprise, for that matter (the danger of nationalisation); as a consequence, no closer integration is possible with these. Occasionally, political conditionality, the specification of political criteria (for associations, for example) means no more than forcing behaviour compliant with international standards.

For political integration (political union), it is obviously more. On the one hand, these formulating communities are organised along the lines of a specified system of political, economic and social values, and all participants are expected to accept it. On the other hand, the specific integration organisation runs common policies and institutions on an increasing scale, and the democratic nature and efficiency of these is a community interest. Antidemocratic

behaviour and development of a community member may endanger the whole community, its safety, well-being and stability. Political and social pursuits and value systems at the same time may not be detached from the respective communities; they are dependent on their historical and cultural traditions, development level, economic and social relations, and the diversity of their compositions.

The Treaty of Rome had stipulated certain political criteria for potential members (democracy, belonging to Europe), but the first formal political criteria for accession were specified for the Central and Eastern European candidates in 1993 in Copenhagen (democracy, legitimacy, stability of institutions that guarantee human and minority rights), which was complemented subsequently in 1995 in Madrid (operational institutions of democracy). Later, in the Treaty of Amsterdam, political membership criteria were implemented against member countries. It was no accident that the political conditions related to the eastern enlargement were extended, although a more specific definition has still not been provided. Accordingly, the candidate countries were required to meet the following major criteria:

❶General enforcement of democracy (Treaty of Rome, 1957). In this context, the major principles are formulated as early as in the agreements on association. As a membership criterion, Central and Eastern European countries are practically required to implement political transformation consistently and fully: commitment to plural democracy, rule of law, enforcement of human rights, fundamental political, economic and cultural liberties, minority rights, multi-party system, free and democratic elections, freedom of the media, market economy and social justice. Similar expectations were expressed for other associations, too.

❷Stability of democracy and institutions (Copenhagen, 1993). It must be no accident that the stability of democracy is emphazized in the Copenhagen criteria. The eastern European transition is precisely a proof that it is insufficient to establish the formal democratic frameworks, and stable democracies are far from having developed in all countries. The EU has not specifically defined the parameters of stability, they were only possible to be concluded from the problems voiced in the regular reports. The stability of democracy is also addressed in the literature of politology. The stability of democracy and its institutions is associated with the settlement of political debates and problems in parliamentary and democratic circumstances; with the balance of power relations among the political parties; with the parliamentary consensus allowing for the governability of the country; as well as with the maintenance of legal security and public safety.

❸Operation of democratic institutions (Madrid, 1995). Efficient operation of democratic institutions is applicable to the operation of the legislative, executive and judicial branches of power – to a degree that is in line with the principles of democracy –, to the adoption and practical application of legal harmonisation, to anti-corruption action, as well as to the development of legal security and public safety, and, finally, to the implementation of social and economic processes that serve the country's growth.

❹It is a new development in the history of European integration that political membership criteria have become a part of the community law, and member states are also called to account for compliance with these (Amsterdam, 1997; Nice, 2000). The first attempt is made in the Treaties of Amsterdam and Nice to handle extreme populist forces gaining power in EU member states, which deny European democratic values. By this, compliance with the principles of democracy has practically become an internal membership criterion.

Contrary to the Council of Europe, the EU holds no possibility to exclude a member state. At the same time, articles 6 and 7 of the Treaty

of Amsterdam are the first to allow for sanctions against member states violating the European democratic standards (as was implemented against Austria).

When the situation of new member states was examined prior to 2004, it was clear that the requirements for accession and integration maturity were met in a political respect. Still, multiple countries showed discrepancies in terms of enforcing minority rights, anti-corruption action or the operation of certain institutions. The past years have proved that Hungary is among the most stable democracies in the region.

Institutional implications are attached great significance from the aspect of integration maturity. Institutional frameworks provide the forms of implementing the integration process, and considerably determine the efficiency of integration policies and measures. With the integration deepening and especially the progress of the economic and monetary union, the significance of institutional conditions and criteria is growing.

It has been voiced multiple times that compliance with the institutional membership criteria will be handled as a key aspect on selecting acceding countries on closing membership negotiations. Ultimately, this was not what happened in practice, and the issue was decided on political grounds. The Europeanization of the domestic system of institutions is a post-accession task, and is expected to take a long time.

Related to enlargement, the Copenhagen criteria stipulated the necessity of adaptation also for old members states (capability of the EU to accept new members). These were not specified to detail, but the main courses and areas of the necessary reforms were mostly identifiable and accepted. Agreement was apparent on the following measures in particular: making the system of institutions suitable to accept new members, a reform of the common agrarian policy, a budgetary reform and successful implementation of the EMU programme. The issue of absorption capacity is particularly acute in terms of future enlargements (primarily for Turkey).

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