

Comment on “The Global and Regional Outlook in the Baltics,” by Piritta Sorsa

Per Magnus Wijkman

Piritta Sorsa’s paper marshals the facts nicely, provides incisive insights and presents diplomatically formulated understatement concerning policy recommendations. My comments will focus on a question common to all the countries treated at this conference: what is the right policy balance between regional economic integration, global economic cooperation and domestic reforms? While EU membership is the declared policy priority for most countries in former “Eastern Europe”, it is unlikely to occur in the near future. The best way to speed up accession may be to hasten domestic reforms, to participate in key international economic institutions and to deepen integration in Europe. This is especially true for the Baltic countries.

The prospects that the Baltic states will achieve EU membership in the near future are less bright than for other states. They are small countries on the periphery of the European Union. They are close to the ex-USSR, they lacked national institutions when they regained independence. Hence, institution-building is crucial for their transition to a market economy and this takes time. Consequently, the Baltic states face special and formidable challenges in their pursuit of EU membership. They may not be the last in the queue, but they can hardly be said to have a head start in the race. A number of states have indicated that they expect to become EU members immediately after the turn of the century. In my view some time around 2010 is a more likely date for most countries. With EU membership uncertain and distant, it would be most unwise to focus policy efforts exclusively on that goal. All eggs should not be put in one policy basket. The appropriate balance for the Baltic States must include a heavy emphasis on domestic reform and participation in Western economic organisations other than the EU.

Regional Integration

Sub-regional integration is often advanced as a stepping stone to EU membership. True enough! But this begs the key question: what is the appropriate sub-region? The European Commission made a Baltic Free

Trade Agreement a pre-condition for the Europe Agreements in much the same way as CEFTA was made a precondition for trade agreements with the Visegrad four. These trade agreements are good in principle but one deludes oneself if one believes that they will contribute much to solving the economic and political problems of the Baltic countries. Piritta Sorsa's paper well illustrates the limited benefits that such sub-regional integration provides for the Baltic countries by highlighting the relatively small size of intra-Baltic trade. Creating a Baltic sub-region and linking it to CEFTA can hardly be a primary policy option for the three Baltic states. It would be little more than a satellite appended to a satellite dependent on Brussels.

The relevant sub-region for them is Northern Europe. No doubt they find it more interesting to deepen East-West integration in Northern Europe than to strengthen North-South integration on the eastern fringe of Europe. The trade routes of the Hanseatic League once connected the Baltic Sea with the North Atlantic Sea and probably still provide a useful basis for sub-regional integration. Each Baltic State may well have greater communality of interest with the Nordic countries and Germany than with each other and with the CEFTA countries. Upon regaining independence the Baltic states expressed interest in becoming members of the Nordic Council, reflecting their perceived communality of interest. At the time the Nordic states were preoccupied with securing EU membership. Maybe they would be more receptive to such overtures today than they were then. If so, they could provide an important contribution to sub-regional cooperation.

The same reasoning applies to the other countries in Central and Eastern Europe. They also assign top priority to East-West integration rather than to deepening or widening integration through CEFTA. The sub-regions that interest them include at least Germany, Austria, France or Italy in Western Europe. Hence their understandable reluctance to define sub-regions as encompassing only countries in the east of Europe.

Sub-regional integration is a useful exercise in the proper context. Clearly, the eastern countries can benefit from extending the free trade now established with the EU to each other as well. In economic terms, it does not make sense for them to discriminate against each other in favour of the countries of the EU. But in political terms, it makes sense for them to want this pan-European free trade to take place within a Pan-European institution. They are reluctant to set up a sub-regional trading institution in the east which is then linked with a sub-regional trading institution in the west of Europe. They view Europe as the relevant region of which they are a part and wish to see institutions which encompass the region as a whole.

A European customs union encompassing the EU and the applicant

countries would accomplish this. It would eliminate the hub-and-spoke patterns which favour investment in the hub rather than in the spokes. It would provide a common set of rules of origin and full cumulation of origin throughout most of Europe. It would make it easier to deal with contingent protection and restrictions on sensitive products. While acknowledging the benefits of the Europe Agreements, Piritta Sorsa illustrates nicely what she calls “a certain imbalance” in the agreements. For instance, the EU’s quotas on textile exports from Latvia and Lithuania curtail the development of a sector where there is a large potential for trade and foreign direct investment. The same applies to the surveillance on textile imports from Estonia. These types of restrictions are easier to maintain in a hub-and-spoke system where the hub negotiates bilaterally with each spoke. The bargaining power of the “spokes” is strengthened in a Pan-European institution by the possibility of forming coalitions with each other and with individual members of the hub.

Domestic Reform

Vigorous domestic reform is a pre-condition for EU membership. Key domestic policies in the Baltic countries are liberalisation of markets, privatisation and adoption of the *acquis communautaire* especially in the areas of competition policy, company law and services. In addition, the Baltic countries need to build institutions and train personnel in the fields of tax collection, statistical systems and customs administration. Successful domestic policies in these fields are essential for attracting investment, especially foreign investment, and promoting growth. Growth can dramatically improve the prospects of accession simply by closing the income gap. If the applicant countries grow at 6 per cent per annum over the next ten years while the EU countries continue their long-term trend of 1.5-2.0 per cent growth, many of the budgetary concerns vexing the tired economies of Western Europe can be eased.

Piritta Sorsa rightly stressed that the Baltic countries have a strong comparative advantage in services, in particular tourism and transport. The service sector’s growth potential lies in exports to Western Europe and in *entrepôt* trade between Western Europe and Russia, given the appropriate transport infrastructure. Realising this growth potential depends on obtaining Western marketing skills, technology and capital. Foreign direct investment can play a critical role to this end. It will come on a sufficient scale only if the appropriate domestic policies are in place. This requires a legal framework that can protect private property rights and ensure law and order. Furthermore, the Baltic countries need to adopt the *acquis communautaire* in transport, telecommunications and financial services.

Participation in Western Economic Organisations

The high probability that there will be a long waiting period for a significant number of countries underlines the need to anchor the applicant countries securely in Western institutions such as WTO and the OECD during the pre-accession period. Nevertheless, several countries in Eastern Europe have experienced difficulties in becoming members of WTO, and progress in attaining membership in OECD has been slow.

Our mental map tends to remain one where Europe is divided into an eastern and western part without pan-European institutions. The countries of the former CMEA and Warsaw pact remain in an institutional vacuum waiting to be admitted into Western institutions, whether EU or NATO. This may not worry those geopoliticians who feel that the balance of power has shifted sufficiently so that developments in Russia do not constitute a threat to states bordering on Russia. But one does not need to believe that what we today assume is irreversible can indeed be reversed to have cause for concern. It is sufficient to note that the political stability of these countries depends on economic progress and that this in turn depends on rapid economic and political integration with the West. Therefore it is imperative that pan-European institutional arrangements be set up to anchor these countries securely among the Western democracies in the long interim period that for many of them may well proceed membership of the European Union.

This may be difficult to imagine, but if the EU can have a customs union with Turkey, why can it not have a customs union with the other applicant countries to the EU? A customs union was considered as a part of the EEA Agreement but was rejected by those countries which wished to maintain their own commercial policy towards third countries. This is not the case with the applicant countries who are prepared to accept the EU commercial policy. Given their readiness, the question is rather: why do they not unilaterally adopt the EU tariffs sooner – rather than later? A customs union encompassing the EU and all applicant countries would be an important step in integrating the European region. It would be especially important to take this step if EU membership appears to take time for many of the applicant countries.

Conclusion

Let me conclude in the spirit of the hierarchy of values that Miroslav Hrnčíř has referred to. What is the European Union all about? It is ultimately to achieve post-war reconciliation and ensure peace in Europe. The common market is more than a free trade area. The internal market is

more than a programme of supply-side economics. The pooling of national sovereignty is to achieve more than just economic prosperity. The fundamental aim of the common endeavour that is the European Union is to ensure that national rivalries in Europe will never again set off a world war. Two world wars in this century have left a bitter heritage. The European Union has been extremely successful in overcoming this heritage. It has produced post-war reconciliation between Germany and its western neighbours. However, the process of reconciliation has only recently been started between Germany and its eastern neighbours in the new Europe that has emerged after the fall of the Berlin Wall. Completing this unfinished business is a major task for the European Union. Czechoslovakia and Poland were, after all, the prime victims of the German aggression that initiated the Second World War. The war would have started sooner if France and the United Kingdom had honoured security commitments to Czechoslovakia as they later did in the case of Poland. The logic of post-war reconciliation and peace through economic and political integration that has proved so successful in Western Europe also holds for Eastern Europe. The first step in this process is EU membership for Poland, the Czech Republic and Slovakia. The *economic* difficulties of eastern enlargement are well known – but beside the point. Post-war reconciliation with the first victims of the Second World War is a *political* imperative. The accession of these first victims of the Second World War cannot be allowed to be determined by a purely economic calculus. If this happens, the European Union will have lost its soul and *raison d'être*.