

# **EUROPEAN UNION ENLARGEMENT: THE IMPLICATIONS FOR JAPAN**



DELEGATION OF THE EUROPEAN COMMISSION TO JAPAN

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## INTRODUCTION

The accession process with Bulgaria and Romania is approaching its end. Accession negotiations with the two countries were concluded in December 2004 and a Treaty of Accession was signed in April 2005, with a view to welcoming both countries as members as of January 2007. This treaty is currently being ratified. The European Union officially launched accession negotiations with Croatia and Turkey at the General Affairs Council in Luxembourg on 3 October, 2005.

All the Western Balkans have a European perspective. Albania, Bosnia and Herzegovina, and Serbia and Montenegro, including Kosovo under United Nations Security Council Resolution 1244 of 10 June, 1999, are potential candidate countries. In December 2005, the European Council granted candidate country status also to the former Yugoslav Republic of Macedonia, with whom accession negotiations have not yet started.

### *EU Membership Application Dates*

Bulgaria .....	14 December, 1995
Croatia .....	21 February, 2003
Romania .....	22 June, 1995
Turkey.....	14 April, 1987
The former Yugoslav Republic of Macedonia .....	22 March, 2004

Map of the enlarging European Union



The accession of **Bulgaria and Romania** will complete the fifth enlargement of the European Union, which started in May 2004 with the accession of ten new Member States, mostly from central Europe.

Accession conditions for Bulgaria and Romania were agreed upon in an Accession Treaty signed in April 2005 between the 25 Member States and the two countries. Bulgaria, Romania and 14 Member States have already ratified the document. This Treaty provides that Bulgaria and Romania will join on 1 January, 2007 unless the Council decides, upon a recommendation from the Commission, to postpone the accession of either country until 2008.

The Commission is firmly committed to ensuring that both countries successfully complete their final accession preparations. To that end, it has closely monitored the progress made by the two countries and has provided targeted support to help them in their reform efforts.

Both countries can be commended on their achievements in successfully transforming their political and economic systems into functioning democracies and market economies. The Commission's May 2006 report confirmed that Bulgaria and Romania met the political criteria for membership and showed that both countries should be prepared for membership by 1 January, 2007, provided they address a number of outstanding issues.

The Commission will continue to provide support for Bulgaria's and Romania's preparations for membership. Nevertheless, if shortcomings persist upon accession, the Commission will take the necessary action in its role as guardian of the treaties and will consider whether the date of their accession to the European Union on 1 January, 2007 can be maintained.

The enlargement process took another major step forward on October 3, 2005 when the EU opened accession negotiations with **Turkey and Croatia**. After years of preparation – decades, in the case of Turkey – the two candidates formally began the next stage of the accession process.

The accession negotiations will be conducted according to a Negotiating Framework that sets out the method and the guiding principles of the negotiations, in line with the December 2004 European Council conclusions. The substance of negotiations will be conducted in an Intergovernmental Conference with the participation of all Member States on the one hand and the Candidate State on the other.

In order to ensure progress in the negotiations, the candidate countries will also need to make progress on the ground in meeting the membership requirements, most importantly the Copenhagen criteria:

- the stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- the existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union;
- the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union and the administrative capacity to effectively apply and implement the acquis.

The Commission has begun the analytical examination, commonly called screening, which marks the first phase of accession negotiations. This year-long process which takes around a year, allows candidate countries to familiarise themselves with the acquis, and the Commission and the Member States to evaluate the degree of preparedness of candidate countries prior to negotiations.

The European Union is strongly committed to the stabilisation and development of the **Western Balkans**, and its strategy is to draw the countries of the region closer to the prospect of European integration.

The EU's first initiative attempt to stabilise the Western Balkans was the Royaumont Process, launched in December 1996 under the French EU Presidency, which aimed to support the implementation of the Dayton

Peace Agreements. It focused on promoting regional projects in the fields of civil society, culture and human rights. The Royaumont Process is now responsible for inter-parliamentary relations under the Stability Pact.

In April 1997, the EU General Affairs Council adopted the Regional Approach, establishing political and economic conditionality for the development of bilateral relations with the five countries in the region – Albania, Bosnia and Herzegovina, Croatia, the then Federal Republic of Yugoslavia and the former Yugoslav Republic of Macedonia. Conditions include respect for democratic principles, human rights, the rule of law, protection of minorities, market economy reforms and regional cooperation.

The European Commission proposed, on May 26, 1999, the creation of a **Stabilisation and Association Process (SAP)** for the five countries to provide a new framework for the development of relations between these countries and the European Union, one which will remain the EU policy for the Western Balkans all the way to membership.

In order to develop a closer relationship with the EU, these countries will have to gear their political, economic and institutional development to the values and models underpinning the European Union: democracy, respect for human rights and a market economy. The Union will support and assist them in introducing the necessary reforms to progress in these areas.

The SAP offers the possibility for the countries of the region to sign a new kind of Agreement, the **Stabilisation and Association Agreement**, with the EU, opening up concrete EU accession perspectives for the first time, as the Union did for Central and Eastern European countries.

So far the EU has opened SAA negotiations with Albania, Croatia, FYROM, Serbia, and Bosnia and Herzegovina. The newly independent Republic of Montenegro may also be invited to negotiate such an agreement, provided they meet all the political and economic condition. In the case of Kosovo, negotiations could not be opened as the country does not have treaty-making power. Nevertheless, a so-called Stabilisation and Association Process Tracking Mechanism (STM) has begun with the aim of offering a forum for discussing implementation of the European Partnership.

Similar to the “Europe Agreements” with previous candidate countries, the SAA provides the contractual framework for relations between the Union and Western Balkan countries until the latter’s accession. Stabilisation and Association Agreements cover areas such as:

- political dialogue;
- regional cooperation;
- the four freedoms, with the creation of a free trade area by 2007 for industrial products and most agricultural products;
- approximation of the legislation to the EU acquis, including precise rules in such fields as competition, intellectual property rights and public procurement;
- wide-ranging cooperation in all EU policy areas, including justice, freedom and security.

The SAA trade provisions are asymmetrically in favour of the Western Balkan countries, meaning the EU has granted these countries unlimited duty free access to the market of the enlarged Union for virtually all products. The only exceptions are veal, fisheries products and wine, for which tariff quotas remain. Western Balkan countries will gradually phase out customs duties for industrial products from the EU by 2007.

The Stabilisation and Association Process is a strategy explicitly linked to the **prospect of EU accession** and is adjusted to the level of development of each of the countries concerned, allowing them to move at their own pace.

**Enhanced regional cooperation constitutes an essential element** of the process and is a qualifying indicator of the Western Balkan countries’ readiness to integrate into the European Union. The **Annual Report on the Stabilisation and Association process** assesses the readiness of the Western Balkan countries to move closer to the European Union. It summarises individual countries’ progress during the reference period, monitors the development of regional cooperation and assesses the impact of the

Stabilisation and Association instruments. Detailed Progress Reports on each country are also published alongside the annual release of the Enlargement Package.

At the June 2003 Thessaloniki Summit, the EU reaffirmed its commitment to integrating into the Union the countries of the Western Balkans. The Stabilisation and Association process was enriched by including salient aspects of the enlargement strategy, so that it can better meet the new challenges. The Thessaloniki Agenda introduced an array of new instruments to support the reform process in the Western Balkan countries and to bring them closer to the European Union. The most far-reaching of these new instruments are the **European Partnerships**, inspired by the Accession Partnerships for the candidate countries. The first set of European Partnerships was approved in 2004: by identifying short and medium-term priorities that the countries need to address, the European Partnerships will help the Western Balkan countries with their reforms and future membership preparations.

At the March 2006 Salzburg Summit, the European Commission reinforced the message that the objective of accession for the Western Balkans is supported by the Union and adopted a Communication offering an enhanced policy for the region. The paper – known as the “Salzburg Communication” – sets out practical measures to reinforce EU policy and instruments, and to integrate the people of the region into the European mainstream by promoting, among other things, facilitation of visas, trade, and education (for instance, by offering more scholarships for students from the region).

All the countries of the Western Balkans have the prospect of future membership of the European Union, an objective endorsed by the European Council in Feira in June 2000 and confirmed by the European Council in Thessaloniki in June 2003.

Croatia and the Former Yugoslav Republic of Macedonia, which have been granted candidate country status, remain part of the Stabilisation and Association Process.

The other countries of the Western Balkans are potential candidate countries: Albania, Bosnia and Herzegovina, Montenegro and Serbia including Kosovo under United Nations Security Council Resolution 1244.

### **Key Dates in the Enlargement Process**

**1987** Turkey applies for full EEC membership.

**1993** Copenhagen European Council approves EU enlargement for countries of Central and Eastern Europe, and defines membership criteria

**1990-1996** Conclusion of Association Agreements (Europe Agreements) with states of Central and Eastern Europe

**1994** Essen European Council approves pre-accession strategy

**1994-1996** Ten states of Central and Eastern Europe apply for EU membership

**1995:** Bulgaria and Romania adopts a decision to apply for EU membership

**1998** Accession negotiations start with Hungary, Poland, Estonia, Slovenia, Czech Republic and Cyprus. Malta reactivates its application for EU membership

**1999** Berlin European Council agrees on “Agenda 2000” and a financial perspective for EU enlargement.

**1999** The European Council in Helsinki decides to start negotiations with Bulgaria, Latvia, Lithuania, Slovakia, Romania and Malta and recognises Turkey as an EU candidate country on an equal footing with other candidate countries.

**2000** Zagreb Summit launches the Stabilisation and Association Process

**2001** First year of the new CARDS programme specifically designed for SAP countries

**2001** The EU Council of Ministers adopts the EU-Turkey Accession Partnership

**2001** Stabilisation and Association Agreement signed with Croatia and the Former Yugoslav Republic of Macedonia

**2002** Copenhagen European Council concludes accession negotiations with Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Slovakia, Slovenia and Poland

**2003** On 31 January, Commission President Prodi officially launches the negotiations for a Stabilisation and Association Agreement between the EU and Albania. These negotiations are ongoing

**2003** Croatia applies for EU membership

**2003** At the Thessaloniki Summit, the SAP is confirmed as EU policy towards the Western Balkans. The EU perspective for these countries is confirmed (countries participating in the SAP are eligible for EU accession and may join the EU once they are ready).

**2003** Signature of the Accession Treaty in Athens, on 16 April

**2004** The Former Yugoslav Republic of Macedonia applies for EU membership

**2004** In June, the European Council confirms Croatia as a candidate country and adopts a European Partnership with Serbia and Montenegro including Kosovo as defined by UN Security Council Resolution 1244

**2004** Accession negotiations with Bulgaria and Romania on all 31 chapters are provisionally closed in December

**2005** The Accession Treaty with Bulgaria and Romania is signed in Luxembourg on 25 April

**2005** In October, accession negotiations with Croatia and Turkey are launched and “screening” stage of accession negotiations begins

**2005** SAA negotiations with Serbia and Montenegro are launched in October, and with Bosnia and Herzegovina on 25 November.

**2005** Decision by the European Council to grant candidate status to FYROM (December)

**2006** In February, U.N.-sponsored negotiations on the future status of Kosovo start

**2006** The Commission’s May Monitoring Report states that Bulgaria’s and Romania’s accession is possible in 2007, if preparation efforts are intensified.

**2006** In May, the Commission calls off SAA negotiations with Serbia-Montenegro due to the lack of cooperation with the International Criminal Tribunal for the Former Yugoslavia

**2006** The Commission begins preparations for Montenegro to negotiate a SAA separately from Serbia after 55.5 percent of Montenegrins vote for independence in a May 21 referendum

**2006** In June, EU and Albania sign an SAA

## **[1] OVERVIEW: BENEFITS FOR JAPAN AND OTHER NON-EU COUNTRIES**

Enlargement will create an even larger market than before, allowing freer movement of goods and services; it will extend the single set of rules for business to a wider area; and it will raise the standard of rules in force across the region. As a result, there will be many new opportunities for Japanese business.

### **1.1 A larger market**

Non-EU countries will benefit from a bigger Single Market and simplified and enhanced access to the markets of the new Member States.

- In trade terms, there are currently no internal borders between EU Member States and the harmonisation of regulations and standards ensures a freer circulation of goods and services than is possible within some non-EU countries. Enlargement will extend these characteristics to the acceding countries. A Japanese investor established in Romania will have the freedom to provide services throughout the EU 27 under the same conditions as operators from other Member States.
- The EU will reinforce its position as the biggest consumer market among developed countries, with a population exceeding 500 million as more states are expected to join in the next few years.
- The enlarged EU will account for some 19% of world trade and a quarter of world Gross Domestic Product. It will be the source of 46% of world outward Foreign Direct Investment (FDI) and host to 24% of inward FDI.

### **1.2 A single set of rules for business**

Enlargement will extend the EU’s trade policy regime to the acceding countries. The current system, featuring a single trade regime for the EU and a different regime for each of the future Member States, will disappear. A single set of trade rules, a single tariff, and a single set of administrative procedures will apply right across the enlarged Union. This will greatly simplify the dealings that Japanese operators have within Europe.

- Beyond the simplification of procedures, enlargement will bring a range of immediate and tangible economic benefits to Japan. These will arise out of the accession countries adopting the same open standard of treatment of third countries that the current EU applies.
- The “one standard for all” principle of the single market on technical regulations will be extended to the acceding countries.

### **1.3 A more open economy with a high standard of rules**

The high standard of treatment currently afforded to investors in the EU will be applicable throughout the enlarged Union. Freedom of establishment for inward investors will be extended to the new Member States. This means that the right of establishment and free movement of capital will be applicable to all companies set up in the new Member States, irrespective of their ownership. Japanese and other foreign investors will benefit from the fact that:

- They will receive enhanced levels of intellectual property rights (IPR) protection in the new Member States due to these countries’ adoption of EU directives in this field. The Europe Agreements already contain an obligation for Bulgaria and Romania. In the SAP context, CARDS Regional IP Programme was designed to support the economic development of the Western Balkan countries through effective and adequate protection and enforcement of industrial and intellectual property rights in line with the requirements of the SAA and WTO.
- No accession country is a member of the WTO’s Government Procurement Agreement (GPA). Upon accession, all new Member States will automatically be subject to the GPA via membership of the European Community (EC), and they will apply the EC legislation on public procurement. Bidders established in the EU, either in current Member States or the acceding countries, cannot be discriminated against on the ground of nationality.
- Current EU commitments to Japan under the GPA will not be affected and Japanese goods, services and suppliers may benefit from new opportunities in the enlarged EU.
- The harmonisation of legislation gives all companies a regulatory framework based on existing laws and standards with which they are already familiar. As barriers to trade fall and the ongoing huge infrastructure investments come to fruition, intra-EU trade is expected to flourish even more.

### **1.4 New opportunities for Japanese businesses**

Enlargement also opens new opportunities for successful export economies like Japan. Japanese entrepreneurs can benefit from developments in Europe through the obvious advantages of being locally present in a market of nearly half a billion consumers with no impediments to free trade, agreed standards and harmonised legal frameworks and regulation.

- Particularly in areas where Japan has an international comparative advantage, such as in manufacturing, automotive, consumer electronics, mobile phones and information technology, Japanese companies will be in a favourable position to benefit from faster growth rates and increasing living standards in the Union.
- Based on earlier examples of EU enlargement, as in the cases of Ireland (1972), Spain (1986), and Finland (1995), strong growth impetus is expected in the new Member States. Dynamic development will, however, not be limited to these countries alone. It will also extend through the entire European Union and its neighbouring regions.
- Production in any of the new Member States now can serve customers in all areas of Europe.
- Building upon their comparative advantage of lower labour costs and upgraded infrastructure, the accession countries will enable cost-efficient production, facilitate access to all Member States, and serve as a gateway to other eastern European countries and Russia.

## [2] MACROECONOMIC BENEFITS OF ENLARGEMENT

### 2.1 Facts and Figures

Enlargement is a positive-sum game for all parties involved. It will be beneficial for the acceding countries, current EU Member States and non-EU countries like Japan, who trade with and invest in the Union.

The EU is by far the most important trading partner for the south-eastern European countries. In 2005, total trade between the EU and these countries amounted to €79 billion, up 53% compared with 2001. All countries experienced an increase in trade with the EU during that period. The largest increases were recorded by **Romania** (+67%) and **Bulgaria** (+52%), highlighting the important process of trade and economic integration following from the EU accession process. In 2005, trade between the EU and Bulgaria amounted to €12.4 billion, a figure that has doubled since 1995. The figures for Romania are equally impressive. In 2005, EU-Romania trade hit €37.1 billion, a figure that has tripled since 1995<sup>1</sup>.

The evolution of EU imports from the **Western Balkans** since the year 2001 – i.e. when the EC autonomous trade preferences in favour of these countries entered into force – gives an indication of the effectiveness of these preferences. Between 2001 and 2005, EU imports from the Western Balkans grew by 38%, but differences vary widely between countries. Although this is a slower rate of growth when compared to Bulgaria and Romania, it is nevertheless a good indication that the EU trade preferences have had an expansionary effect on the Western Balkans' export performance<sup>2</sup>.

The EU and **Turkey** enjoy a deep trade relationship, and the EU ranks by far as number one in both Turkey's imports and exports, while Turkey ranks 7th and 6th in the list of the EU's import and export markets, respectively. Textiles dominate EU imports from Turkey, accounting for about 40% of the total. Other important imports are transport material (16.3%), agricultural products (8.9%) and office machinery and telecommunications equipment (5.8%). Turkey's imports came from the following key markets: the EU (52.4%), Russia (7.5%), USA (4.6%), Switzerland (3.9%), China (3.5%), Japan (2.4%). Main EU exports to Turkey are machinery (28.3%), chemical products (16.4%), and transport material (19.1%)<sup>3</sup>.

Although it may take some years for the new Member States to catch up with current EU income levels, enlargement is expected to **increase the growth of GDP**. The experience of past EU accessions offers encouraging prospects for the new Member States. For example, two years after the Union grew to 25 Member States, economic growth in new Member States has been on average 3¾% and the resulting catching-up process has seen the EU-10 average income rising from 44% of the EU-15 level in 1997 to 50% in 2005<sup>4</sup>.

Due to the effects of this fifth round of enlargement, existing Member States could also see an increase in their level of GDP, possibly by 0.7% on a cumulative basis over the next decade. In the medium-to-long term, however, growth and trade effects could be more significant than this. This is not only due to higher growth and demand in the new Member States, but also to stronger supply side effects, with restructuring of industries in both new and existing Member States. The extension of the Single Market to candidate countries will foster greater competition, increased investment and economies of scale for new and existing Member States<sup>5</sup>.

### 2.2 Enlargement mechanisms

Enlargement will bring down remaining barriers and simplify regional trade. As a result, trade is expected to expand, especially in those sectors for which trade liberalisation under previous trade agreements was incomplete, such as agricultural products. Much of the increase is expected to be in intra-industry trade.

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<sup>1</sup> [http://trade.ec.europa.eu/doclib/docs/2006/april/tradoc\\_128213.pdf](http://trade.ec.europa.eu/doclib/docs/2006/april/tradoc_128213.pdf)

<sup>2</sup> [http://trade.ec.europa.eu/doclib/docs/2006/april/tradoc\\_128215.pdf](http://trade.ec.europa.eu/doclib/docs/2006/april/tradoc_128215.pdf)

<sup>3</sup> [http://ec.europa.eu/comm/trade/issues/bilateral/countries/turkey/index\\_en.htm](http://ec.europa.eu/comm/trade/issues/bilateral/countries/turkey/index_en.htm)

<sup>4</sup> 'Enlargement, two years after', Occasional Paper, n.24, 2006, EC.

<sup>5</sup> European Commission, *The Economic Impact of Enlargement*, June 2001.

[http://europa.eu.int/comm/economy\\_finance/publications/enlargement\\_papers/enlargementpapers04\\_en.htm](http://europa.eu.int/comm/economy_finance/publications/enlargement_papers/enlargementpapers04_en.htm)

Financial market integration has made progress with the modernisation of the banking sector in the acceding countries, particularly with the help of foreign banks and improvements in financial intermediation efficiency.

Foreign Direct Investment (FDI) has also played a role in the transformation of the acceding countries' economies, not only as a tool for manufacturing sector modernisation, but by complementing domestic savings and supporting demand. FDI flows have anticipated enlargement and increased rapidly: according to statistics provided by the National Bank of Romania, the improvement of the business climate, the effects of the flat tax, and positive attitude of foreign investors towards the country determined the attraction of a record volume of FDI in 2005, registering a 26.8% increase against the same period last year and reaching €5.20 billion<sup>6</sup>.

According to the preliminary records of the Bulgarian National Bank, FDI in Bulgaria between January and September 2005 were €1.32 billion, an 11.5% growth in comparison to the same period last year, when the figure was €1.19 billion<sup>7</sup>.

### **2.3 Exchange Rate Mechanism (ERM) II and Euro adoption**

All but three of the current EU Member States (Denmark, Sweden and the United Kingdom) have adopted the euro in place of their former national currencies. The new Member States have also expressed the intention eventually to join the Eurozone. The EU Treaty clearly defines the path for full monetary integration of the acceding countries. They will not be able to adopt the euro immediately upon accession, but will first have to comply with the relevant EU Treaty requirements, including the exchange rate criterion, which foresees a minimum two-year participation in the Exchange Rate Mechanism (ERM II).

Upon accession, the new Member States will participate in the Economic and Monetary Union (EMU) with the status of "Member States with a derogation" from adopting the euro. This status is confirmed in the Accession Treaty. It means, *inter alia*, that the acceding countries will take part in the European System of Central Banks.

New Member States will have to treat their exchange rate policy as a matter of common concern. This implies they should avoid rates that are inconsistent with economic fundamentals, excessive exchange rate fluctuations and competitive devaluations. They are expected to join ERM II at some point after accession. Furthermore, new Member States will have to regard their economic policies as a matter of common concern and hence will be subject to the EU's policy coordination and surveillance procedures.

For the next step – euro adoption – the Treaty requires that new Member States achieve a high degree of sustainable convergence, assessed against the convergence criteria laid down in the Treaty.

Deciding on rapid entry into the Eurozone should be taken in light of each country's specific situation. However, a new Member State that meets all the convergence criteria and has achieved a high degree of economic convergence with the Eurozone could join the new exchange-rate mechanism after accession and then, after the two-year test phase, introduce the euro.

**The EU Single Market, unified by a single currency, reduces trade barriers, reduces risk and has created a more competitive market environment. These benefits continue after enlargement. As a result, cost and price increases are not expected.**

## **[3] TIMETABLE FOR PHASING IN EU STANDARDS AND REGULATIONS**

In order to determine the conditions under which each country will join the EU, negotiations have been held with all the acceding countries. From the day of accession, new Member States will accept the *acquis communautaire*, the detailed laws and rules adopted on the basis of the EU's founding treaties.

<sup>6</sup> Romanian Agency for Foreign Investment, <http://www.arisinvest.ro/level1.asp?ID=396&LID=2>

<sup>7</sup> <http://www.investbg.government.bg/cgi-bin/e-cms/vis/vis.pl?s=001&p=0002&n=000060&g=>

The negotiations focused on the terms under which the applicants will adopt, implement and enforce the *acquis communautaire*, and, notably, the granting of possible transitional arrangements which must be limited in scope and duration. Under similar arrangements in previous accession negotiations, new Member States have been able to phase in their compliance with certain laws and rules by a date agreed during the negotiations.

It is not possible in this brief publication to include every chapter of the negotiations, or to list all the specific transitional arrangements agreed with each accession country. Below are the chapters and transitional arrangements most relevant to Japanese interests.

These chapters were closed in December 2002 with the 10 new Member States and in December 2004 with Bulgaria and Romania.

### **Chapter 1 – Freedom of Movement of Goods**

The principle of free movement of goods is one of the cornerstones of the Single Market, and requires a common regulatory framework to ensure products can move freely from one part of the Union to another just as they would within the boundaries of an individual country. This means that basic technical standards, product certification and metrological definitions must be governed by rules established at European level.

Without the full application of EU legislation in this area from the first day of accession, the internal market would not function properly. The EU therefore expects acceding countries to apply the *acquis communautaire* at the latest by the date of accession.

### **Chapter 2 – Freedom of movement for persons**

All nationals or citizens of EU Member States are automatically citizens of the European Union. Every citizen of the Union has the right to travel and remain and live freely on the territory of any Member States. This includes the right to take part in European Parliament and municipal elections in his/her place of residence. The *acquis* covers the four broad areas of mutual recognition of professional qualifications, citizens' rights, free movement of workers, and coordination of social security schemes.

For the accession countries (except Malta and Cyprus), a common transitional arrangement was put forward with regard to the free movement of workers. The general right to free movement between countries of the EU is open to all and is not affected by the transitional arrangement agreed for workers. Thus, there are no additional restrictions on movement, for example, for study or residence purposes. However, movement for purposes of work, as an employee, is restricted for up to seven years. The current Member States are, however, free to apply the restrictions or not on a national level.

The essential component of the transitional arrangements is a two-year period during which national measures will be applied by current Member States to new Member States.

Depending on how liberal these national measures are, they may result in full labour market access. Following this period, reviews will be held, one automatic review before the end of the second year and a further review at the request of the new Member State.

The transition period should come to an end after five years, but it may be prolonged for a further two years in those Member States where there are serious disturbances of the labour market or a threat of such disruption

### **Chapter 3 – Freedom to provide services**

The *acquis* in this chapter relates to financial services, such as banking, insurance and investment services and securities markets. It contains a number of Directives, including the protection of personal data and the free movement of such data; special rules concerning the freedom of establishment and the freedom to provide services for craftsmen, traders and farmers; self-employed commercial agents, and Information Society directives on the provision of information in the field of technical standards, regulations and rules.

Transitional arrangements: Lower level of investor compensation until the end of 2009 (Bulgaria); lower level of investor compensation until the end of 2011 (Romania).

#### **Chapter 4 – Free Movement of Capital**

The definition of free movement of capital covers much more than cross-border payments and transfers of money. The Treaty establishing the European Community not only prohibits all restrictions on movement of capital between Member States, but also, in general, between Member States and non-EU countries. The Member States can, however, retain certain restrictions in relation to countries outside the EU. This includes the transfer of ownership of assets and liabilities, such as investments in companies and real estate or portfolio investments.

Furthermore, the chapter covers the area of payment systems, and includes the two Directives on cross-border credit transfers and on settlement finality, as well as the Directives on preventing money laundering.

*Transitional arrangements agreed for Bulgaria and Romania:*

- I. A five-year transitional period for the acquisition of secondary residences, excluding EEA citizens who reside in the future Member State from the scope;
- II. A seven-year transitional period for the acquisition of agricultural and forestry land, excluding self-employed farmers from the scope.

#### **Chapter 6 – Competition Policy**

The competition *acquis* covers issues such as state monopolies of a commercial character, rules applicable to undertakings, public undertakings and undertakings with special or exclusive rights.

The control of mergers is based on the EC Merger Regulation 4064/89 (as amended). Part of the *acquis* on state aid is addressed under other chapters, namely transport, agriculture and fisheries. The Directives concerning the liberalisation of the energy, transport and telecommunications and information technologies sectors are also addressed under separate chapters.

*Transitional arrangements agreed with Romania:*

- I. Phase-out of incompatible fiscal aid by 31 December, 2011 under the Law on Free Trade Areas for undertakings, which signed commercial contracts before 1 July, 2002. State aid is granted for regional investments and the net aid intensity must not exceed 50% net grant equivalent (up to 65% for SMEs provided the total net aid intensity is not more than 75%). In the automobile sector, total aid shall not exceed a maximum of 30% of the eligible investments costs.
- II. Phase-out of incompatible fiscal aid by 31 December, 2010 under the GEO on Deprived Areas for the undertakings, which were awarded a permanent investor certificate before 1 July, 2003. State aid is granted for regional investments. The net aid intensity must not exceed 50% net grant equivalent (up to 65% for SMEs provided the total net aid intensity is not more than 75%). In the automobile sector, total aid shall not exceed a maximum of 30% of the eligible investments costs.
- III. The Accession Treaty contains a safeguard clause in the area of the Internal Market as well as a specific safeguard that will allow postponing the envisaged date of accession by one year to January 2008. For Romania, any serious shortcomings observed in the 2005 Commission's report in the area of Competition Policy, especially as regards the state aid enforcement record, can activate either safeguard clause. The use of the postponement safeguard clause requires a decision by the Council acting by qualified majority (normally unanimity is required) on the basis of a Commission recommendation if it is based on shortcomings in Romania's fulfilment of specific conditions in the Competition area. In addition, the Accession Treaty provides for a mechanism whereby state aid granted before accession and after 1 September, 2004 will be reviewed after accession and, if found to be illegal, impose reimbursement, in the case that Romania does not sufficiently improve its state aid enforcement record.

#### **Chapter 9 – Transport Policy**

The road transport-related *acquis* covers a vast area of social, technical, fiscal, safety and environmental requirements. The railway *acquis* calls for a further opening of national railway markets to competing railway undertakings from other Member States. In aviation, issues of market access, safety and infrastructure organisation have to be addressed. In maritime transport, the enforcement of the maritime safety *acquis* remains a major task.

*Transitional arrangements:*

**Bulgaria:** access of non-resident hauliers to the national road transport market of other Member States to be phased in gradually (as described above); financial standing criterion for transport operators carrying out domestic transport services (until 31 December, 2010); gradual increase of axle-load limits on national road network (until 31 December, 2013)

**Romania:** access of non-resident hauliers to the national road transport market of other Member States to be phased in gradually (as described above); gradual increase of vehicle taxes for certain vehicles used in domestic transport (until 31 December, 2010); gradual increase of axle-load limits on national secondary road network (until 31 December, 2013)

## **Chapter 10 – Taxation**

The EU *acquis* in this chapter mainly covers indirect taxation, in particular Value Added Tax (VAT) and excise duties regimes, while the *acquis* on direct taxation is limited to legislation on corporate taxation.

*Transitional arrangements agreed with Bulgaria and Romania:*

Turnover threshold to exempt SMEs from VAT set at about €25,000 (Bulgaria) and €35,000 (Romania); VAT exemption for international passenger transport; special excise regime for fruit growers' distillation for personal consumption; lower excise duty rates on cigarettes until 31 December, 2009.

## **Chapter 13 – Employment and Social Policy**

Employment and social policy covers areas where substantial secondary legal *acquis* exists at EU level, such as health and safety issues, labour laws, and the equality of treatment between women and men, as well as areas such as social dialogue, employment and social protection where convergent policies are being developed, on the basis of the EC Treaty. In these areas there are no legal obligations to implement precise policy measures, but a very important general obligation to coordinate the respective policies in order to develop a homogenous social framework in line with the principle and rules of the EU Treaty.

*Transitional arrangement agreed with Bulgaria:*

Directive 90/239/EEC as modified by Directive 2001/37/EEC (maximum tar yield of cigarettes) until 31, December 2010

## **Chapter 19 – Telecom, IT and Postal Services**

The overall objective of the EU telecommunications policy is to promote the competitiveness of the EU market and to stimulate investment in an environment of rapidly developing technologies. The telecommunications sector is now a high growth area in the European economy in its own right, as well as an important stimulant for the economy as a whole.

*Transitional arrangements agreed with Bulgaria:*

One two-year transitional period (Implementation of Directive 98/61/EC, notably the aspect of number portability)

## **Chapter 22 – Environment**

The environmental *acquis* covers a wide range of measures, mostly in the form of Directives, covering issues such as environmental quality protection, polluting and other activities, production processes, procedures and procedural rights as well as products. Apart from horizontal issues (environmental impact assessments, access to information on environment, combating climate change), quality standards are set for air, waste management, water, nature protection, industrial pollution control, chemicals and genetically-modified organisms, noise, and nuclear safety and radiation protection (safety issues arising from the use of nuclear energy are part of the energy chapter).

*Transitional arrangements:*

**Bulgaria:** sulphur content of liquid fuels until 2011; emissions of volatile organic compounds from storage of petrol until 2009; recovery and recycling of packaging waste (amended Directive) until 2014; landfill of certain liquid wastes until 2014; shipment of waste until 2009; waste electrical and electronic equipment until 2008; integrated pollution prevention and control until 2011; treatment of urban waste water until 2014; air pollution from large combustion plants until 2014.

**Romania:** emissions of volatile organic compounds from storage of petrol until 2009; recovery and recycling of packaging waste (amended Directive) until 2013; landfill of certain liquid wastes until 2013; waste landfills until July 2017 (instead of 2009 for Member States); shipment of waste until 2011; waste

electrical and electronic equipment until 2008; integrated pollution prevention and control until 2015; treatment of urban waste water until 2018; quality of drinking water until 2015; discharges of dangerous substances into surface water until 2009; air pollution from large combustion plants until 2013 and 2016-2017; incineration of hazardous medical waste until 2009.

### **Chapter 23 – Consumer Protection**

The *acquis* for the chapter on consumers and their protection is composed of the following areas: misleading advertising, product liability, doorstep sales, consumer credit, dangerous imitations, package travel and holiday tours, product safety, unfair terms in consumer contracts, time-share, distance selling, comparative advertising, prices on foodstuffs and guarantees for sale of consumer goods and injunctions.

### **Chapter 24 – Justice and Home Affairs**

EU policies on Justice and Home Affairs aim to maintain and further develop the Union as an area of freedom, security and justice. Perhaps the most practical component of the EU's Justice and Home Affairs policies is the Schengen Agreement (see section 8 below), which results in the lifting of internal border controls for EU citizens as well as non-EU nationals. However, accession to the EU will not immediately lead to the lifting of border controls between existing and new Member States. As with previous enlargements, this will be the subject of separate Council Decisions some time after accession, based on a careful examination of the legal and practical readiness of the new Member States, in particular their ability to control their external borders.

### **Chapter 25 – Customs Union**

From the first day of accession, the customs administration of the new Member States will have to manage and control their borders, which will then be external borders of the EU, in the interest of the EU population and trade operators. The *acquis* in this field consists mainly of a number of instruments ensuring the functioning of the Customs Union and the effective protection and control of its external borders.

## **[4] CONSEQUENCES OF ACCESSION COUNTRIES' ALIGNMENT WITH THE COMMON CUSTOMS TARIFF**

Upon accession, the new Member States will have to adopt the Common Customs Tariff (CCT) for trade in goods. There have been fears expressed by some countries outside the EU that this will result in an increase in accession countries' customs tariffs to the rest of the world. On the contrary, the average weighted industrial tariffs of the acceding countries are in general higher than the estimated EU average of 3.6%. The overall level of tariff protection in the acceding countries will decrease after enlargement.

For example, Bulgaria's tariffs currently average 15.1% on all products, 24.4% on agricultural products, 13.5% on fishery products and 12.6% on industrial products. By comparison, EC tariffs currently stand at 5.3% on all products, 9.4% on agricultural products, 12.4% on fishery products and 4.2% on industrial products<sup>8</sup>. Upon accession, Bulgaria's tariff protection will significantly diminish on an increasing number of products coming from Japan.

This applies to an even greater extent in the case of Romania: its external tariff protection will be reduced upon accession from the current 17.5% to the EU level<sup>9</sup>. Thus, Japanese businesses will benefit from lower tariffs in their trade with the new Member States.

In the case of services, providers in Japan and other non-EU countries will benefit from the implementation of the single market in acceding countries, where they will get the same treatment as in the rest of the EU.

### **4.1 WTO Compensation**

As discussed in section 2 above, the integration of new Members into the EU will contribute to the expansion of world trade. Should other WTO Members estimate that they are negatively affected, they can seek

<sup>8</sup> <http://www.mi.government.bg/eng/integration/eu/docs.html?id=15842>

<sup>9</sup> [www.wto.org/english/tratop\\_e/tpr\\_e/s155-3\\_e.doc](http://www.wto.org/english/tratop_e/tpr_e/s155-3_e.doc)

compensation according to WTO rules. The EU will, of course, fully comply with its obligations under the relevant WTO rules.

## [5] INVESTMENTS INCENTIVES AND STATE AIDS AFTER ENLARGEMENT

Relations between the EU and acceding and candidate countries are governed by **Association Agreements, the Customs Decision** (Customs Union Agreement in the case of Turkey) **and subordinate provisions** adopted under these instruments, such as implementing rules for antitrust and state aid, specific to each country.

Competition has been one of the crucial chapters in all enlargement negotiations. And for obvious reasons: any country intending to join the Internal Market must prepare its economy to cope with competition. If an acceding state were unprepared, its companies would risk economic failure. And this is also why in this area above all others, it is actions and not words that matter. Mere political “commitments” are insufficient when it comes to competition discipline. In this vitally important field, three elements have had to be put in place well before accession by all acceding countries: the necessary legislative framework, an adequate administrative capacity and a credible enforcement record. In general terms, conditions for foreign investors will therefore not significantly change with the accession of the new Member States. This is because, under the Europe Agreements, future Member States are required to implement EU state aid rules.

Nevertheless, Japanese investors will benefit from the increased legal certainty associated with EU membership. At institutional level, the responsibility for state aid control will shift from the countries’ own authorities to the European Commission. The European Court of Justice in Luxembourg will be in charge in case of disputes.

The question of transitional arrangements has been approached with the aim of preserving the integrity of the Single Market after enlargement, while at the same time allowing the possibility of constructively addressing specific problem areas for the acceding countries. They have been accepted under the condition that they must be exceptional, limited in time and scope, and accompanied by a plan with clearly defined stages for the application of the *acquis communautaire*.

As regards fiscal aid, e.g. tax breaks, tax holidays, and tax credits as well as offshore arrangements, a series of negotiated measures has been agreed. The European Commission worked closely with the acceding countries to find arrangements whereby these aid measures can be brought into line with the *acquis communautaire* within a reasonable period of time.

## [6] OTHER EFFECTS OF ENLARGEMENT FOR JAPAN

### 6.1 Trade defence instruments

Upon accession, the 27 Member States of the enlarged EU will constitute one single market with one single set of trade defence rules applied at the EU-wide level. This implies that the acceding countries will no longer apply trade defence action on a national basis. All measures taken by the acceding countries will disappear and acceding countries’ on-going investigations will cease.

The set of laws and measures currently applicable in the current 25 Member States will be automatically applicable in the acceding countries. The EU investigations that are on-going will continue to be pursued – except for those related to exports from the acceding countries.

Enlargement will not automatically render current trade defence measures inappropriate in the EU27 context. In cases where enlargement does change the fundamental economic factors, economic operators can request that measures are reviewed.

The EU does not expect any increase in TDI cases after enlargement, for both legal and economic reasons. Given that EU trade defence action is very limited, and even more so regarding Japan, enlargement will have no impact for Japan in this field.

## Trade Defence Instruments

Trade defence instruments exist to counter unfair trade practices by third countries when exporting to the EU. Such unfair trade practices normally emanate from distortions in third countries (due inter alia to imperfect competition or high tariff or non-tariff barriers).

The EU is a very prudent user of trade defence instruments. Only 0.5% of imports into the EU are under measures and less than 0.1% of Japanese imports are under measures.

Trade defence measures are imposed only if strict legal and economic criteria are fulfilled. The EU criteria are even stricter than those of the WTO, and will still apply after enlargement where new Member State action is replaced by EU-wide action, as will the traditionally conservative use of safeguards by the EU.

Enlargement will not automatically vary the economics on which current EU-25 trade defence measures are based. For cases where enlargement changes the economics, general or enlargement-specific reviews can be requested in order to adjust or abolish measures. It is firm EU policy to have TDI measures *exclusively* where unfair trade is causing injury to the EU industry.

Contrary to the belief of certain parties, no increase in TDI cases by the EU is *a priori* expected after enlargement. Indeed, the economics in most cases will mean that if there is no trade problem today at EU-25 level, the picture will not be very different at the EU-27 level.

### 6.2 Bilateral Agreements: the Mutual Recognition Agreement (MRA) and the Agreement concerning Cooperation on Anti-Competitive Activities

Mutual Recognition Agreements enable reciprocal recognition of the results of conformity assessment. Through an MRA, an exporting party is given the authority to test and certify products against the regulatory requirements of the other party, on its own territory, before exporting. In cases where countries require mandatory third-party certification of specific products, each importing party agrees, under the terms of the MRA, to recognise the tests, certificates and approvals issued by agreed conformity assessment bodies of the exporting party. Thus, products can be exported and enter the other party's market without undergoing additional procedures.

The EU-Japan Mutual Recognition Agreement is intended to reduce the cost of certifying products for conformity with the two parties' technical regulations. The products covered are in four specific areas: pharmaceuticals, chemicals, telecommunication equipment and electrical equipment.

The agreement potentially covers trade worth an estimated €1.36 billion a year (¥2.83 trillion at September 2003 rates), and mean annual savings for exporters of up to €400 million (¥53 billion). The Agreement came into force on 1 January, 2002 and will extend to new Member States after accession.

The extension of the MRA to 10 more Member States offers new possibilities to Japan as products certified under the terms of the MRA will circulate freely in these countries. There will be no need to amend the body of the agreement, though minor amendments will need to be introduced to the Annexes.

## Mutual Recognition Agreements (MRAs)

### *What are the benefits that will arise out of the adoption of the *acquis* by the new Member States?*

The trade facilitation advantages of access to non-EU markets which MRAs have brought to EU exporters will extend to new Member States. Conversely, the same kind of advantages would accrue to the exporters of the third countries with which the EU has concluded MRAs as regards their exports to the new Member States.

### *What does implementation of the Common Commercial Policy (CCP) by acceding countries entail?*

New Member States will automatically participate in international agreements to which the EU is a party. This includes MRAs, with the ensuing obligations to have in place a suitable mechanism for the designation of Conformity Assessment Bodies (CABs) if they have the intention to designate them. Their actual ability to do so, in certain MRAs (e.g. Switzerland), has been built up already before accession by the conclusion of a Protocol to the Europe Agreements on Conformity Assessment (PECAs) between the EU and most acceding

countries. These are based upon the implementation of the *acquis communautaire* and are designed to align the conformity assessment systems of the acceding countries to the EU system. In other MRAs, new Member States will need to demonstrate, through the procedures set up in the MRAs, knowledge of the regulatory requirements of the third party in order to designate CABs.

***How will the obligations towards third countries be respected?***

The obligations of the MRAs will become immediately applicable upon accession in the new Member States. From the first day of their accession, the new Member States will be obliged to accept certificates issued in Japan in accordance with the MRA, just as they will be obliged to accept certificates from each other and from the current 25 Member States. Furthermore, the MRAs include safeguard mechanisms to ensure that the CABs and the competent authorities have the necessary and adequate technical competence: verification visits, peer reviews, etc. These will also automatically apply to new Member States upon accession.

A further point specific to third countries is that MRA co-signatories can question the technical ability of new Member State's CABs to certify products to the technical requirement of the importing country. New Member States will need to demonstrate knowledge of the regulatory requirements of the third party in order to designate CABs. However, the mechanism of the PECAs and the Community's technical assistance are designed to solve this problem in the context of the Internal Market, and will therefore also address it in the cases of MRAs based on the *acquis communautaire*.

On 10 July, 2003 the European Community and the Japanese government signed an Agreement concerning Cooperation on Anti-Competitive Activities. The agreement should contribute to the effective enforcement of the competition laws of Japan and the EU through promoting cooperation and coordination between their competition authorities.

Under the agreement, the two sides may request the other party to take action against anti-competitive behaviour carried out in its territory. It enhances international cooperation in the fight against cartels and provides for regular contacts in order to discuss policy issues and enforcement efforts and priorities.

As the agreement has been concluded by the European Community, no changes will be necessary on the accession of the two new Member States, as there is no change in the contracting party. According to Article 1.2(b) of the Agreement, the European Commission will have to send the Japanese government an updated list of national competition authorities.

### **6.3 Dialogue between the EU and Japan**

In addition to the official bilateral agreements that exist between the EU and Japan, there are also a number of non-legal agreements in which the new Member States will participate after accession:

- **The EU-Japan Action Plan:** Since December 2001, the EU and Japan have been implementing the Action Plan, which has four main objectives: promoting peace and security, strengthening the economic and trade partnership, coping with global and societal challenges, and bringing together people and cultures. Implementation of the Action Plan is reviewed at each EU-Japan Summit.
- **Regulatory reform dialogue:** The EU and Japan have been actively participating in each other's regulatory reform efforts since 1995 through an intensive discussion on deregulation. They cooperate closely, exchanging lists of proposals for regulatory reform on an annual basis and engaging in a series of high-level and expert meetings. New Member States will be able to propose regulatory reform measures via the European Commission, and Japan will be in a position to propose regulatory changes in the new Member States.
- **EU-Japan Business Dialogue Round Table (EJBDRT):** In order to provide a more focused and proactive business input into EU-Japan relations, the EJBDRT was created in 1999 by merging the EU-Japan Industrialists Round Table and the EU-Japan Business Forum. The board members of 44 leading EU and Japanese enterprises meet for a round-table discussion once a year to review issues affecting trade, investment and industry, and to make policy recommendations to the EU and the Japanese government. The EJBDRT is co-chaired by two senior business executives, one from each side.
- **Asia-Europe Meeting (ASEM):** This is an informal process of dialogue and cooperation bringing together the 25 EU Member States and the European Commission, with the ten ASEAN countries

(Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam), and China, Japan and South Korea. The ASEM dialogue addresses political, economic and cultural issues, with the objective of strengthening the relationship between our two regions, in a spirit of mutual respect and equal partnership. The ongoing process includes summit-level meetings every second year, ministerial-level meetings in the intervening years (although now normally annually) plus a range of meetings and activities at the working level. New participants are admitted by a consensus decision of the ASEM Summit.

## **[7] ACCESS TO STRUCTURAL & COHESION FUNDS: FINANCIAL ASSISTANCE**

The EU provides specific targeted financial aid for acceding countries, candidates and potential future members in order to support their efforts to enhance political, economic and institutional reforms.

### **7.1 Pre-Accession Assistance for acceding countries**

The Instrument for Structural Policies for Pre-accession (ISPA) was developed by the European Commission to help central and eastern European countries comply with EU environmental and transport standards. With an annual budget of around €1 billion, ISPA's approach is similar to that of the Cohesion Fund, which finances projects designed to improve the environment and develop transport infrastructure in lower-income Member States. Japanese companies established in the EU can bid for contracts under the rules currently applicable for projects financed by structural funds.

ISPA is one of three pre-accession instruments to aid countries preparing for accession over a seven-year period (2000-2006) and is accompanied by Sapard (support for the modernisation of agriculture and for rural development) and Phare (support for institution building, developing community programmes, regional and social development and industrial restructuring/SME development).

With accession, all the new Member States will become beneficiaries of the EU's Regional Policy. For the 2004-2006 period, €2 billion was set aside for assisting regional development in the new Member States. One third of this amount is earmarked for the Cohesion Fund that supports (similarly to the pre-accession instrument ISPA) major investments in transport and the environment that are of national and EU significance, such as railways, highways, waste and wastewater treatment. About €14 billion is foreseen for the four Structural Funds that operate on a regional level. The Structural Funds support the development of regional infrastructure and investments that create or safeguard jobs (European Regional Development Fund), human resource development (European Social Fund), rural development (European Agricultural Guarantee and Guidance Fund) and the development of areas dominated by the fishery industry (Financial Instrument for Fishery Guidance).

### **7.2 Financial Assistance for the Western Balkans**

The CARDS (Community Assistance for Reconstruction, Development and Stabilisation) Programme underpins the objectives and mechanisms of the Stabilisation and Association Process, which is the EU policy framework for the Western Balkan countries until their eventual accession: Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Serbia and Montenegro, including Kosovo as defined by UN Security Council Resolution 1244.

Croatia, which has been granted candidate country status, is benefiting from pre-accession financial assistance while remaining eligible for participation in the CARDS regional programme.

### **7.3 IPA – The new instrument for pre-accession assistance from 2007 onwards**

The Commission has decided to create a single Instrument for Pre-Accession Assistance (IPA) for the period covered by the next Financial Perspectives (2007-2013).

It will replace the 2000-06 pre-accession financial instruments PHARE, ISPA, SAPARD, the Turkish pre-accession instrument, and the financial instrument for the Western Balkans CARDS. IPA will concern the countries with candidate status (currently Croatia, the Former Yugoslav Republic of Macedonia, Turkey) and potential candidate status (Albania, Bosnia and Herzegovina, Serbia, Montenegro and Kosovo).

## [8] THE SCHENGEN AGREEMENT

### 8.1 Schengen, the free movement of persons, immigration, visas and asylum

The Schengen *acquis* poses a huge challenge to the candidate and acceding countries. It implies the removal of borders between EU Member States, referred to as internal borders. Lifting internal borders is necessary to guarantee one of the fundamental rights of EU citizenship: the right to move and reside freely throughout the Union, enshrined in Article 14 of the EC Treaty and in the provisions on Union citizenship (Article 18). However, before internal borders can be lifted, a special evaluation process must conclude that the country concerned is able to apply the “compensatory measures” specified in the Schengen *acquis*. These relate to external border control, visa policy, police cooperation, mutual assistance in criminal matters and the ability to participate in the computerised Schengen Information System (SIS). A new version of the Schengen Information System (SIS II), which will be able to connect all new Member States, is currently being developed. Most Member States already apply common rules in these areas as a result of the Schengen agreements, now incorporated into the Community framework (Articles 61 to 69 of the EC Treaty). In practice, the current EU border control *acquis* has been developed in the framework of Schengen and, in particular, the “Common manual on external borders”.

### 8.2 Increased mobility of Japanese nationals travelling to new Member States and within the EU

The new Member States will have to apply Regulation 539/2001. This regulation lists those third countries whose nationals must be in possession of visas when crossing the EU’s external borders and those whose nationals are exempt from that requirement. Japanese nationals are exempted from the visa requirement, and will thus be able to travel to all new Member States for a stay not exceeding three months without being submitted to visa formalities, from the day of accession onwards. Travelling to the new Member States will thus now be possible under the same conditions as to current Member States.

The only difference between the existing and the new Member States will be that there will still be checks at internal borders between current and new Member States and between new Member States as well. In contrast, there are no checks at internal borders within the territories of the existing Member States applying the Schengen *acquis* (all existing Member States except United Kingdom and Ireland). Schengen does not deal with work permits; for new Member States, as for current Member States, work permits for Japanese and other non-EU nationals continue to be dealt with under national policy and legislation.

## [9] AGRICULTURE

Negotiations on the agriculture chapter with Bulgaria and Romania were concluded in June 2004. The key agreements reached in the negotiations with these countries are summarised below.

### 9.1 Financial and market related aspects of agriculture

The 10 new Member States will gradually phase in EU agricultural **direct payments** between 2004 and 2013. Direct payments started at 25% in 2004, 30% in 2005 and 35% in 2006 of the present system and will increase in 10 steps to reach 100% of the then applicable EU level in 2013. **Bulgaria and Romania**, joining the EU in 2007, will have equivalent treatment and will phase in direct payments starting at 25% in 2007 to reach 100% in 2016. Within carefully defined limits, all new Member States will have the option to “**top-up**” these EU direct payments with national subsidies.

In 2004-2006 (**2007-2009 for Bulgaria and Romania**), a new Member State has the possibility to top up EU direct payments to:

- either 55% of EU level in the years 2004 (**2007 for Bulgaria and Romania**), 60% in 2005 (**2008 for Bulgaria and Romania**) and 65% in 2006 (**2009 for Bulgaria and Romania**). From 2007 (**2010 for Bulgaria and Romania**) the new Member State may top-up EU direct payments by 30 percentage points above the applicable phasing-in level in the relevant year;
- or to the total level of direct support the farmer would have been entitled to receive, on a product by product basis, in the new Member State prior to accession under a like national scheme increased by 10 percentage points.

In no case should the payment be higher than 100% of EU-15 level of direct payments. Rather than applying the standard direct payment scheme applicable in the current EU, the new Member States have the option, during a limited period, of granting their farmers CAP direct payments in the form of a decoupled area payment (a simplified payment scheme). An annual financial envelope will be calculated for the new Member State according to agreed criteria and then divided between the utilised agricultural area.

The new Member States will have special additional financial aid for rural development for a limited period. This includes a higher proportion of EU co-financing in rural development projects. Certain rural development measures have been adapted or created in order to reflect better the requirements of the new Member States in the first years of accession. This means that for a limited period, new Member States will be able to use rural development funds for schemes specifically designed to help restructuring of the rural sector. For example, there is support for semi-subsistence farms undergoing restructuring as well as specific measures to assist farmers in meeting EU standards.

Reference quantities (e.g. quotas, base areas) have been agreed for all the applicable products on the basis of recent production and taking into account country specific circumstances (e.g. drought). In a few specific instances, transitional periods were agreed for the adoption and implementation of certain parts of EU legislation. These transitional periods are exceptional and limited in time and in scope.

## [10] ENLARGEMENT, 2 YEARS AFTER: THE STORY OF A SUCCESS

On the occasion of the second anniversary of the 2004 enlargement, the European Commission published a study confirming that the favourable economic expectations prior to 2004 had been met<sup>10</sup>. The 2004 enlargement can be considered a success.

On 1 May, 2004, 10 new countries with a combined population of almost 75 million joined the EU. The 25-member EU now forms a political and economic area with 450 million citizens and includes three former Soviet republics (Estonia, Latvia and Lithuania), four former satellites of the USSR (the Czech Republic, Hungary, Poland and Slovakia), a former Yugoslav republic (Slovenia) and two Mediterranean islands (Cyprus and Malta). The 2004 enlargement expanded the frontiers of the EU, increased its population and its national income and raised its cultural, historical and economic diversity. Two years later, peace, democracy and prosperity prevail throughout the wider Europe.

The process of convergence and wealth creation that had been under way for over a decade continued and accelerated: the new Member States have reformed and modernised to turn themselves into dynamic market economies while the goal of becoming a member of the EU has stimulated democratic and economic reforms as well as human rights and the rule of law across Europe. The stability brought by accession has allowed increased trade and investment, boosting growth and employment in the EU, thus opening new opportunities and helping firms stay competitive in the global environment, providing consumers across the EU with wider choice in a larger, more integrated internal market.

Enlargement has acted as a force of modernization not just for the new Member States but also for the EU-15. The extension of the Internal Market and the rapid integration of the new Member States in the EU economy have made it possible for enterprises to take advantage of cost and location advantages and to seek improvements in profitability through the spatial reallocation of production. The result has been to create the conditions for the whole European economy to become stronger, more dynamic and better equipped to face increased global competition.

### 10.1 Historic background

This historic enlargement of the EU from 15 to 25 members is the culmination of a long accession process leading to the reunification of a Europe that had been divided for half a century by the Iron Curtain and the Cold War. The fall of the Berlin Wall on 9 November, 1989, marked the disintegration of the entire Communist bloc in Eastern Europe. This event was the starting point for the process of European

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<sup>10</sup> 'Enlargement, Two Years After', Bureau of European Policy Advisers and Directorate General for Economic and Financial Affairs, Occasional Paper n. 24, 2006, European Commission.

reunification. From then on the EU and the candidate countries worked together to prepare the enlargement within the framework of bilateral accession partnerships between the EU and each candidate country. The partnerships set the priorities and precise timetables for the ground which needed to be covered to enable each country to take on the obligations involved in accession.

Officially, the invitation to apply for membership was made in the 1993 Copenhagen European Council that set out the Copenhagen criteria that needed to be met before membership was considered. Membership criteria require that a candidate country must have achieved: stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities; the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union; the ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union.

During the 1990s, there was a gradual integration of the economies of the candidate countries within the EU as various legal and economic restrictions were gradually removed and the Europe Agreements established the framework for bilateral relations between the EU as a whole and each individual candidate country. The EU supported their work to adopt the Community's rules through its pre-accession strategy. It gave them financial assistance for developing their institutions, infrastructure and economies.

Accession negotiations began on March 31, 1998, with the six best-prepared countries (Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia), and on February 15, 2000 with all the other candidate countries (Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia) except Turkey. They were based on the principle of "differentiation", i.e. each country's progresses at its own pace according to its level of preparation for accession. The length of the negotiations therefore varied according to each country's progress.

The Copenhagen European Council of December 2002 found that 10 of the 13 candidate countries (Cyprus, Estonia, Hungary, Poland, the Czech Republic, Slovenia, Latvia, Lithuania, Malta and Slovakia) fulfilled the conditions necessary for joining the EU. They therefore signed their Accession Treaty on 16 April, 2003, in Athens and officially joined the EU on 1 May, 2004, after ratification procedures were completed.

## **10.2 Economic impact of enlargement**

Since from the beginning enlargement created great expectations and became the cause for a variety of anxieties, several studies were conducted in order to assess potential effects of enlargement on new and old Member States. The results of these studies are broadly consistent with each other and suggest notable gains from enlargement. Enlargement was expected to be beneficial for all Member States but especially so for the acceding ones; the empirical estimates resulting from the above mentioned study of the EU Commission bear this out.

**Economic growth** has been on average faster in the new Member States (3¾% per year in 1997-2005) than in the old (2½%). The resulting catching-up process has seen the EU-10 average income rising from 44% of the EU-15 level in 1997 to 50% in 2005. Particularly impressive catching-up took place in the Baltic countries, but also in Hungary and Slovenia.

Strong economic performance has improved the labour market situation and, after a long period of decline, employment was stabilized in 2004 and expanded by about 1.5% in 2005.

Past catching-up experience bodes well for future convergence. As real, financial and institutional integration continues and EU transfers increase substantially, growth rates in the EU-10 are likely to remain higher than in the EU-15.

Increasing **macroeconomic stability** has accompanied economic growth. Integration into the EU-wide system of economic policy coordination and budgetary surveillance reinforced economic policy discipline in the new Member States, bringing their inflation and interest rates down towards those of the EU-15. And, in public finances, most of them have made progress toward the correction of excessive deficits.

EU accession has coincided with signs of improving **labour market conditions** in the EU-10. On the back of strong economic growth boosted by accession, employment ceased to drop in the EU-10 in 2004 and

expanded by about 1.5% in 2005. Employment growth was above 2% in Lithuania, Poland and Slovakia. Similarly, labour market developments in the EU-15 have been positive over the past two years. Employment growth accelerated to 0.6% in 2004 from 0.4% in the previous year, and increased to 0.7% in 2005.

**Trade** flows between the EU-10 and the EU-15 increased markedly in the period preceding EU accession. The Europe Agreements established free trade between the EU and the EU-10 countries, on the basis of reciprocity, but applied in an asymmetric manner (with more rapid liberalisation on the EU side than on the side of the candidate countries), and with restrictions in a few sectors (e.g. foodstuffs, textiles and clothing). As a result, the EU-15 became rapidly the major trading partner for all EU-10 countries. Since accession, the EU-15 share of the EU-10 trade has remained broadly stable at 62%. This reflects a high degree of trade integration of the recently acceded Member States in the EU-15, which even slightly exceeds that among the EU-15 countries, as intra-EU-15 trade accounts for 60% of the total EU-15 trade. Unlike trade in goods, no significant impact of accession on trade in services between the EU-10 and the EU-15 has been visible to date.

The EU-15 continue to run a substantial trade surplus with the new Member States: the trade of the EU-10 remains dominated by lower technology specialisation using labour intensively, while the trade of the EU-15 is more specialised in products requiring higher levels of skill and capital.

One of the most visible aspects of the ongoing process of economic integration of the new Member States in the EU is the rapid growth of **foreign direct investment** flows into the former. While virtually residual until the mid-1990s, the 2004 stock of inward foreign direct investment in the new Member States reached €91 billions, which represents 40% of the local GDP. The old Member States are the main investors: Germany is particularly active in the Czech Republic, Hungary, Poland and Slovakia, while the Nordic countries are busy in the Baltic States. The Netherlands is the largest individual investor, followed by Germany and France.

The largest part of inward foreign direct investment stocks in the new Member States is concentrated in services (55%), especially in Cyprus and in the Baltic States; manufacturing (37%) takes up an important share in Hungary and the Czech Republic.

Despite earlier fears about relocation of business, flows from old to new Member States have accounted for only a minor part of overall foreign direct investment by the EU-15: in 2004 the outflows to new Member Countries were 4% of the total, compared to 53% for outflows to other Member States in the EU-15, and 12% to the U.S.A. Moreover, much of the FDI by the old Member States has been to make acquisitions in privatisation programmes and has not involved substitution of activities previously carried out in the home country. Similarly, the evidence about employment suggests that as little as 1% of annual job turnover in the EU-15 can be attributed to relocation, and only a part of this relates to relocation to the new Member States.

More stable **financial environments** have emerged in the new Member States (despite some exchange rate volatility), and they have avoided any major financial turbulence. Financial systems are expanding rapidly, as the recent surge in credit growth illustrates. The banking sector has seen integration with cross-border investment and high levels of foreign bank penetration, and the enhanced competition has resulted in cheaper loans, especially mortgages. Net interest margins have narrowed to euro-area levels (0.5%) in Hungary, Latvia and Slovakia. Overall, improved access to foreign financial markets has allowed companies and households in the EU-10 to find cheaper financing and has stimulated growth in firms sales, assets and leverage, thereby supporting the catching-up process.

Even if the direct impact of accession on the EU-15 financial sectors has been limited overall, reflecting the relatively small size of the financial sectors of the EU-8 (the 10 new Member States excluding Cyprus and Malta), accession has offered EU-15 financial intermediaries the opportunity of new growth markets and improved portfolio diversification. Austria, whose banks now have 25% of their assets invested in the new Member States, is a very good example.

**Migratory flows** from the new Member States have in general been small. Since enlargement, there has been an increase in the number of EU-8 workers in EU-15 Member States. However, despite this increase, the relative impact, as measured by the number of permits issued for reason of employment as a proportion

of the host country's working age population, is rather limited. There is moreover no evidence that migration flows from the EU-10 have caused significant labour market disturbances in the EU-15 countries. The potential threats that have dominated recent emotional enlargement debates are overplayed; they are not supported by evidence nor is the potential for large migratory flows from the new Member States to the EU-15 consistent, on the basis of recent trends, with rational reasoning.

The **agricultural sector** is still of relatively greater importance in the economies of the new Member States. Fears that enlargement would have an adverse income effect have not been realized, either in the new or in the old Member States. On the contrary, EU support and an inflow of foreign direct investments has contributed to the restructuring and modernisation of agriculture and food processing in the new Member States. Trade creation has dominated trade diversion as a result of enlarged agricultural markets. Furthermore, accession has considerably increased farmers' real incomes in EU-10 without deteriorating farmers' incomes in EU-15.

## ANNEX I: Country profiles<sup>11\*</sup>

### Accession Countries

#### BULGARIA

##### Diplomatic Relations with Japan:

Diplomatic relations between Japan and Bulgaria, which were severed due to the Cold War, were resumed with the exchange of official documents in September 1959.

Number of Japanese residing in Bulgaria: 156 (October 2005)

##### Trade with Japan for 2005:

Exports: €25.91 million (wine and metal products)

Imports: €30.57 million (machinery, car and chemical products)

##### Trade with EU for 2005:

Exports: €5.3 billion (textiles, clothing, agricultural products)

Imports: €7.1 billion (machinery, transport equipment)

##### Direct Investment from Japan:

Cumulative total for 1992-2004: €20.38 million

##### Japan's Economic Cooperation (total to end of August 2004):

Loans: ¥40.07 billion

Grants: ¥2.63 billion

Technical Cooperation: ¥9.21 billion (total to end of March 2004)

#### ROMANIA

##### Diplomatic Relations with Japan:

After World War II, diplomatic relations between the two countries were reestablished in 1959. Traditionally, Japan and Romania have enjoyed good relations with no significant pending issues between them. Recently, relations have become much closer in a variety of fields, including political, economic, and cultural areas.

Number of Japanese residing in Romania: 289 (2005)

##### Trade with Japan for 2005:

Exports: €141.96 million (industrial products, textiles and wine)

Imports: €122.23 million (electrical machinery and metals)

##### Trade with EU for 2005:

Exports: €15.3 billion (textiles, clothing and agricultural products)

Imports: €21.8 billion (machinery, transport equipment)

##### Direct Investment from Japan:

Cumulative total to end of April 2006: €62.96 million

##### Japan's Economic Cooperation (total to end of March 2005):

Loans: ¥76.37 billion

Grants: ¥2.53 billion

Technical cooperation: ¥8.22 billion. Every year Japan receives almost 60 Romanian trainees and instructs them in such fields as the market economy and environmental protection.

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<sup>11</sup> Data source: European Commission, Japan External Trade Organization, Japanese Ministry of Foreign Affairs

\* Figures converted from dollars, at \$1 = €0.79 rate

## Candidate Countries

### CROATIA

Diplomatic Relations:

Established in March 1993.

Number of Japanese residing in Croatia: 100 (June 2006)

Trade with Japan in 2005:

Export: €23.87 million (marine products, textile)

Import: €46.20 million (autos, general and electrical machinery)

Japan's Economic Cooperation:

Loans: ¥772 million (in fiscal 1996)

Grass Roots Grant Aid: ¥523 million (since fiscal 1998)

Technical cooperation: ¥595 million. 95 trainees brought to Japan (since fiscal 1997)

### FORMER YUGOSLAV REPUBLIC OF MACEDONIA (FYROM)

Diplomatic Relations:

Japan and Macedonia established diplomatic relations in March 1994, after the latter gained independence from the former Federal Republic of Yugoslavia.

Number of Japanese Nationals residing in FYROM: 11 (October 2005)

Trade with Japan for 2005:

Exports: €1.77 million (tobacco and wine)

Imports: €9.32 million (machinery and light-industrial products)

Japan's Economic Cooperation (as of the end of March 2004):

Loans: ¥10.33 billion

Grants: ¥9.37 billion

Technical Cooperation: ¥1.78 billion

### TURKEY

Diplomatic Relations:

Japan recognized the Republic of Turkey in 1924.

Number of Japanese Nationals residing in Turkey: 1,229 (October 2005)

Trade with Japan for 2005:

Export: €1.73 billion (tobacco, processed foods, volatile oils, chrome steel, carpets, glass products)

Imports: €26.40 million (communications, chemical and optical equipment, automobiles, machinery, iron and steel)

Japan's Economic Assistance (total to end of March 2004):

Loans: ¥451.38 billion

Grant aid: ¥1.46 billion

Technical cooperation: ¥36.38 billion

## **Other countries in the Western Balkans**

### **ALBANIA**

Diplomatic Relations:

Established in March 1981.

Number of Japanese Nationals residing in Albania : 5

Trade with Japan for 2005:

Export: €509,550 (automobiles)

Imports: €754,450 (chromium steel, tobacco)

Japan's Economic Cooperation:

Loans: ¥6.97 billion

Grant Aid: ¥3.96 billion

Technical cooperation: ¥1.16 billion

### **REPUBLIC OF SERBIA**

Diplomatic Relations:

Established on 20 May, 1997.

Number of Japanese Nationals residing in Serbia: 102 (October 2005)

Trade with Japan for 2005 (figures for trade with former Serbia and Montenegro):

Export: €8.15 million

Imports: €2.49 million

Japan's Economic Assistance (total to end of 2004, for former Serbia and Montenegro):

Loans: ¥11.04 billion

Grant aid: ¥37.67 billion

Technical cooperation: ¥1.28 billion

### **REPUBLIC OF MONTENEGRO**

Diplomatic Relations:

Established on 16 June, 2006.

Number of Japanese Nationals residing in Montenegro: 4 (based on October 2005 data)

Trade with Japan for 2005: See Serbia

Japan's Economic Assistance: See Serbia

### **BOSNIA AND HERZEGOVINA**

Diplomatic Relations:

Established in February 1996.

Number of Japanese Nationals residing in Bosnia and Herzegovina: 26 (as of October 2005)

Trade with Japan for 2005:

Exports: €2.91 million

Imports: €1.24 million

Japan's Economic Cooperation:  
 Loans: ¥4.11 billion  
 Grant Aid: ¥26.21 billion  
 Technical cooperation: ¥3.46 billion

## ANNEX II: Japanese Investment in Central & Eastern Europe<sup>12</sup>

	2003	2004
Czech Republic	¥18.5 billion	¥18.5 billion
Poland	¥208 billion	¥81 billion
Hungary	¥129 billion	¥96 billion
Romania	¥0.6 billion	¥0.3 billion
Slovakia	¥0.6 billion	¥0.2 billion
Slovenia	-	¥1.5 billion
<b>TOTAL</b>	<b>¥356.7 billion</b>	<b>¥197.5 billion</b>

## ANNEX III: Japanese Manufacturing Affiliates in Central & Eastern Europe

According to data from the Japan External Trade Organization (JETRO), the total number of Japanese manufacturing affiliates in Europe and Turkey at the end of December 2005 stood at 1,007. Of these, there were 173 in Central & Eastern Europe, with the majority – 162 – located in EU-10 Member States.

### EU-10 Member States

Czech Republic ..... 65  
 Hungary ..... 44  
 Lithuania ..... 1  
 Poland ..... 42  
 Slovakia ..... 10

### Accession countries

Bulgaria ..... 1  
 Romania ..... 9

### Other E. European countries

Serbia-Montenegro ..... 1

<sup>12</sup> Source: Japanese Ministry of Finance