



Twenty-Fourth Conference Debate
The Italian Chamber of Commerce and Industry for the UK

**“THE NEW EUROPE: THE BUSINESS AND
INSTITUTIONAL SCENARIO”**

PROCEEDINGS

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Chairman of the Conference:	Erhard Busek <i>Special Co-ordinator, The Stability Pact for South Eastern Europe</i>
Speakers:	Jean Lemierre <i>President, European Bank for Reconstruction and Development</i>
	Alessandro Profumo <i>Chief Executive, UniCredito Italiano SpA</i>
	Nani Becalli <i>President & CEO, GE Europe, Middle East & Africa</i>
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	Peter Mandelson <i>Member of Parliament, Former Secretary of State</i>
Guest of Honour:	H.E. Cardinale Achille Silvestrini

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WELCOME

Leonardo Simonelli: We have a busy morning so I'll start straight away with this short welcome. Ladies and Gentlemen, it is a pleasure to welcome you all to our annual conference. Last night, at Claridges, the British Minister for Europe, Peter Hain, brilliantly introduced the subject we will debate this morning. Many of you were there, but for those who were not with us, I will try to summarise his message as briefly as possible. His approach was both positive and practical, reminding us of the advantages the member countries have already enjoyed together, not only in economic terms, but also as a result of the common social and environmental regulations.

He recommended the strongest co-operation between politicians and business people in order to find the right solution to the problems ahead for the future of Europe, indeed for the "New Europe". This has been the aim of our Chamber in organising this conference and our previous conferences: to provide a platform for discussion about important issues, an opportunity for bankers, industrialists and politicians to exchange views. I'm especially pleased to be able to tell you that I have received a letter from Romano Prodi, the President of the European Commission, who has twice been a speaker at this event and who sends his best wishes for today's proceedings. Mario Monti, the Italian Commissioner, who has spoken twice to our conference, has also underscored the importance of the UK as a location for debates such as this, together with the need to involve as many entrepreneurs and decision makers as possible in the practical implementation of the work of the Convention.

"New" is a word that does not adapt well to a part of the world which has been the cradle of Western civilisation and, in the many centuries of its existence, has absorbed and integrated the other historic civilisations of the South and the East as well as "discovering" the "New World" to the West. After I visited the beautiful exhibition in Florence on the Myth of Europe which is made up of 150 masterpieces dating from 500 BC to the 20th century, I realised how old European roots are and considered that the historical myth of Jupiter foreshadowed the destiny of Europe.

It would probably have been better to use the words of Valéry Giscard D'Estaing, Chairman of the European Convention. In his opening address he stated that the Convention has been called upon to write a new, very important chapter in the history of Europe. Indeed, the aim of the Convention is to prepare a strategic blueprint for the future of the Union. The enlargement (as many as thirteen countries and maybe more to gradually join the Union) requires greater tolerance and understanding in a multi-cultural and multi-religious entity. Integration requires re-elaboration of the concepts of nations and states, and an evermore rational and efficient role of the Union's institutions. After all, it could even be argued that this new chapter is so important that to define it as "New Europe" is not totally wrong. The process of integration is certainly "new" because, for the first time in history, there is a completely peaceful and democratic attempt not only to create a larger open market, to have a common currency, but also to achieve political union on the continent where democracy and nation states find their origins. It is a very difficult task and will take some time because the concepts of global devolution, efficiency, freedom, regulation, innovation, environment,

sustainable development, culture, traditional entity, prosperity, justice, ethics, and the presentation of our individual and collective existence, must be set out in clear and compatible terms.

I am sure that the audience's temptation to simply wish the EU decision makers "good luck" will be an expression of sincerity. However, this is not enough. We are all involved in this process, and it is my opinion that we must all participate in this democratic effort. If the process succeeds, it will be beneficial to the entire world for generations to come. The example of peaceful co-operation between France and Germany, who have fought so many wars in the past, must be our model to overcome tensions in other areas which are causing much suffering and wasted opportunities.

We are living in difficult times, in a period of transition, in which the role and example of "New Europe" is essential. I think we all agree that the title of this year's conference is challenging. We needed speakers up to the task and we have found them. We must thank them for their kindness and generosity in sparing us their valuable time. The two bankers, Jean Lemierre and Alessandro Profumo, the two industrialists, Nani Beccalli and Luigi De Puppi, and the two politicians, Erhard Busek and Peter Mandelson, who form this morning's panel, are men of international stature and experience, and I am sure that they will enlighten us with their thoughts and tell us of their involvement in this great project. I also trust that the audience will show interest in the debate and become involved by asking questions of the panel at the conclusion of the presentations. As Guest of Honour, we are fortunate to have His Eminence Cardinale Silvestrini to give the luncheon speech. His experience in ecumenical wisdom makes him particularly well qualified to conclude the conference.

As usual, my role is very limited because I think that we have to take full advantage of the presence of our speakers and our illustrious participants. I am therefore pleased to place the debate in the very capable hands of our chairman, Dr. Erhard Busek, the Special Coordinator of the Stability Pact for South East Europe, an organisation founded by the Council and the Commission of Europe, in which a total of 51 nations participate. Dr Busek's long and prestigious career is detailed in your programme. He will introduce the speakers, whose CV's are also included.

Again, on behalf of the Chamber and its Council, many thanks to our Guest of Honour, our chairman, our speakers and, of course, to all of you for joining us today. Thank you.

PROCEEDINGS OF THE CONFERENCE

Erhard Busek: Thank you, Mr Simonelli.

Ladies and gentlemen, it is a pleasure for me to be with you and to chair this meeting. Seen from my personal experience, I believe this is an important event. I was born during the Second World War and grew up in the east, close to the “iron curtain” where the free world ended at that time, 60 kilometres from Vienna. If we were moving, if we were travelling, we could only go west and south to Italy. Yet in the other direction, to the east, it was extremely difficult. The world seemed to end there.

I have always been very politically active and in the past I have worked to assist dissidents in the countries on the other side of the iron curtain. My views were shaped by events such as the entry of the Warsaw Pact armies into Prague in 1968. By accident, I was in Prague at that time. I discovered that it was quite easy to support democracy, human rights, and so on in a free society, and I saw how difficult it was to fight for human rights and for freedom of expression in the neighbouring countries.

I openly admit that I did not expect the downfall of the Iron Curtain, the communist system, the Warsaw Pact or the Soviet Empire during my lifetime. I always admire those who declare now that they had always known that it might happen around 1989. People I met under very difficult circumstances, for whom I was trying to secure release from imprisonment, had a lasting effect on me. Many of them later became presidents, prime ministers, members of parliament, university lecturers, and this was quite moving for me.

This is one of the reasons why I am now politically committed to South East Europe. I have strong feelings about a common Europe, about the common roots of Europe which are based on Greek philosophy, Roman law, Judeo-Christian thinking, the Enlightenment, Modernism etc. We now have the opportunity to build a new Europe, as Mr Simonelli has said. It began with the Treaty of Rome, driven by the political movements which followed the Second World War. So far, it has been a success story. Sometimes we forget this! We always read about the difficulties, about the agricultural policy and who fights whom. But in general, I think it is a big success story, because for centuries there were difficulties between the Germans and the French. Many wars were fought and many people killed. Let me add, as an Austrian, that Alto Adige is not a problem for us, because it was solved in a very European manner and this is a very good example for South East Europe, where we have seen some examples of aggression between majorities and minorities.

Today, we have a conference on “New Europe” and I think that through the fall of the Iron Curtain and the Berlin Wall and the changes in the political systems, we are in a position able to build this new Europe. It is a great advantage. I am happy to see that the business community is spearheading such changes. If we look at South East Europe, we see that the economy might even be the easiest of the changes required, but nonetheless it is extremely important. If we do not generate more wealth and more people with a regular and liveable income, there will be no stability. If the differences in income remain too large in Europe, we shall continue to have many problems. Here, the business community has – besides making business, which is your profession – an important social and

political role. Sometimes we must be reminded of this! As business increases, we have a large window of opportunity to create stability for all of Europe, at the dawn of the 21st century.

Since September 11, we all know that such developments take place in a global context. Our continent should not be perceived as Fortress Europe, because South East Europe, like the Black Sea area, is connected to the Middle East and reaches into Central Asia. This has implications for organised crime. In this context, I am very grateful to the British Government, because on November 21 they will hold a conference here in London on “Organised Crime in South East Europe”. The British government is inviting all the Interior Ministers. It is very positive that businesses are able to work globally. However, organised crime is also able to work globally, which is extremely dangerous. We cannot fight it only at a national level.

Please excuse my personal remarks which, I hope, have shown the great importance of our conference. Every contribution, every business you start in the candidate countries of the European Union -- and in the countries which are not yet candidates for the European Union, but are nevertheless part of Europe -- is very important for the process of political stabilisation, which reduces differences between these countries. As long as we have differences, the temptation for migration and crime is strong. An individual with no money seeks to change his or her situation. If this cannot be done legally, it will be done in another way, which extends from the grey economy to horrible crimes. It is our responsibility to break this cycle, and I am happy that such a large number of business people are doing so. Please bear in mind our basic relationship to this question.

I do not exaggerate when I say that we are doing a truly European job here. From a human perspective, this job is very necessary. I was a member of Government, when we wrote a letter to Brussels, requesting Austrian membership in the European Union. From that time until entering the European Union, I believe the situation in Austria improved by virtue of the fact that we were neighbours of the European Union. I think we are all winners. So much has been written about the difficulties, the problems, the high levels of unemployment – you know all of this. However, there is so much to gain. Certainly, we are saving money by not having to defend ourselves with military force, and being able to co-operate in this European style. I mention this with deep respect for Italy, one of the spiritual cradles of Europe and we shall keep this spirit in mind.

Thank you for allowing me to make these remarks. Now, I shall take the chair for the first session. Our first speaker, Jean Lemierre, is the President of the European Bank for Reconstruction and Development, an institution of great importance. You may understand that as Special Coordinator the Stability Pact for South East Europe, I have deep respect for Mr Lemierre who is always very helpful.

Jean Lemierre: Thank you.

It is a pleasure to be here with you this morning. I would like to share a few opinions with you, rather than making a speech. I have been in London long enough to have forgotten the French habit of long speeches, so I shall simply make a few remarks, to try to convey the vision we have in the Bank. Most of the members of our board are here today, including Enzo Quattrociocche representing your country, Italy, one of the most important shareholders of the Institution. The management and

many of my colleagues are here with me this morning, which should convey the importance this meeting holds for us.

I like the conference title, “New Europe”, very much. I will say a few words about “New Europe” and about the borders of “New Europe”, because at the EBRD we are working in Central Europe, South East Europe, Central Asia and Russia. We need a new vision of Europe, not only the future EU countries, but also the countries which share their Eastern borders. This is very necessary for us as we have been working there now for ten years. Enlargement is no longer a dream. It will be decided in Copenhagen, or later; this is not my point. Enlargement concerns eight countries in our region. They are as ready as they can be, which is crucial. Today they are being encouraged by you and by the EU, and they are preparing themselves to be members of the EU. The big economic zone will be created tomorrow. Do they have difficulties, or as the English say, do they have challenges? Yes, many, and I will tell you a little about them.

These countries have made significant progress. You know this, because you invest there. They want to be European, they have questions. In particular, they want to know what the institutional arrangement of Europe will be, because they want to have a say in the future, which is a fair wish. Otherwise, they have prepared themselves quite well. The Baltic states are highly advanced, as is Slovenia. Hungary is attractive for investment, and the Czech Republic is moving forward very quickly. Slovakia has achieved great strides in the public sector and is now working on privatisation. Poland has made substantial achievements despite the difficulties inherent in such a large country, and we need to understand this.

The main challenge for these countries is competition. This is not easy for them, because they have to restructure old industries and agriculture. They have to promote new skills and respond to their citizens’ desire for a better standard of living. As EU members, they can wait for subsidies from Brussels, which they will receive as is only justified. They also know that if they want to avoid two-tier fiscal pressure, on themselves and on the EU budget, they need to attract private sector investment. This is the only way forward, and I think they agree.

As the French say, at the bottom of their heart they understand that they have to do this. There are political problems and problems of social cohesion. You may see short-term difficulties, but it is clear that they understand this point perfectly well. They need to attract investment: green fields, brown fields. They need to finance their developing economy and increase the financial capital bases of their economies. Yet, first of all, they need good banks. I am very happy to be here with Mr Profumo, because many Western banks, from Italy, Austria and Germany, have created a new banking activity, sometimes with the help of the EBRD, specifically to finance the real economy in a more efficient way. This is really crucial. The main challenge from our point of view, is to finance the real economy in a very efficient way. We are committed to supporting this, but may I say that the banking sector in Central Europe today is improving thanks to you.

These countries present very good opportunities for investment. The marketplace is large, the labour costs are low, although they differ from country to country, and the workforce is skilled. However, from our point of view, this is not enough. We need to think now about the new borders of Europe, because we need a new vision for this large region. Part of the challenge of the enlarged EU is

to trade better with the other side of the border and to avoid a new curtain. It's a big challenge, and bankers don't like curtains very much. It may be difficult, but that's a question for you, not for me.

"New Europe" is a driving force for the entire region and nobody should underestimate the strength of this force. People want to join; they want to be seen as European. As a European myself, I find this an extraordinary cause. There are many expectations and we have a responsibility to deliver. You are the key to making this happen through business. For example, as Mr Busek knows, the situation in the Balkans is very clear. We feel that Serbia and Croatia are driving the Balkans. They are the two biggest countries, with governments highly committed to reform. You already invest a great deal in Croatia and I hope you are going to invest also in Serbia because these two countries are moving fast. Serbia has probably made more reforms in one year than some other countries in ten years, and they are highly committed to delivering results.

However, I also would like to mention two important countries which could enter in the second stage of enlargement – Bulgaria and Romania. We believe Bulgaria is a stable country. Their exchange rate system represents a very strong commitment and they stick to it. They are attracting investment and they have made a very clear choice of development based on export. Romania is moving in the same direction. In the first years of transition, Romania was an important country of investment for the EBRD, and then there were two or three years where the bank did nearly nothing. The situation is now changing with the new government. The privatisation of the national steel company was a huge challenge. We are working on pre-privatisation of the national oil company, which holds symbolic resonance, and we are working on the privatisation of BCR, one of the largest retail banks in Romania. There is a new government with a clear commitment to progress. They have challenges. I hope there are no journalists here, but corruption is a challenge. I say this - and some people in Romania don't like me to say this - but there's corruption, and the government is trying to reduce it, and that's a fact. And we need to fight. There is an extraordinary small business sector, and you know it very well, because when I visit them, they say to me that they are suppliers to Italian companies. This is good, and you know why you are there.

Russia is improving and is more stable. There has been an extraordinary recovery since the 1998 crisis. Mr Putin is giving the country stability and predictability. They are being helped considerably by the price of oil. The key issue for Russia is the implementation of reforms. However, they are attracting investment. I would like to convey the message that the region is stable, and is moving forward. They have learned quickly from the lessons of 1998 and they are building institutions and can offer good opportunities for investment. When you look at "New Europe", you are at the crux of the European countries Mr Busek has been discussing, which are future EU members. What can we do for you? Speeches are good, but money is better, because then you take the risk.

We have been created by you and we use your money, taxpayers' money. We have 62 shareholders of which Italy is one of the most important; indeed it is the second largest. It's your money, so use us. If you don't use us, you lose your money. What do we do? Something people don't do so much any more. We take risks. Indeed, we have been established to take part of your risk and assist you in investing in this region. That's exactly what we do. Risk taking is our business. Perhaps, as Mr Profumo says, you don't see many bankers today who are happy to take your risk, but we are.

That's the way we work. We can do it in various ways, and we work with many of you. In particular, we have been working a great deal with Mr Profumo. We work with many Italian companies, and you could do much more in the region, indeed maybe you should. We are ready to assist in various ways. We can offer you financing, in the form of loans and equity investments. However, if I may insist on one point, which is sometimes forgotten, we can enable your clients to pay you. This is crucial to our approach.

Through our record with Italian companies you know how we operate, but I will give you two or three examples. We have built a facility with German banks to finance the investment of Mittelstein in Central Europe. I'm available to do this with any company in Europe. We reduced the German bank's investment risk for the companies they finance. We have also been working with Bosch in the Ukraine. Bosch operates through franchising. Part of their problem was finding investors willing to take the Ukrainian risk. We have implemented facilities with Bosch to finance the franchising system in the Ukraine, and this is very crucial for the company. My third example is in Russia. I will not name the bank concerned, but the American company Caterpillar had a problem because they wished to sell large equipment in Russia. We have divided the final risk so that we take one third of the risk, Caterpillar takes one third, and the bank, a private bank, takes one third of the risk.

Through such approaches, we can be highly innovative compared with the normal business – equity investment or loans. We believe these countries are important. We place emphasis on transparency and governance and we work with you in accordance with your needs. We listen to you and try to tell you what we can do to help these countries. I hope you understand that we strongly believe in the challenges of “New Europe”, the enlarged “New Europe”. It's an extraordinary opportunity for all of us. It may raise questions for you at board level and at management level, but believe I think we can do well for the people of the region and we can contribute to good business, at the same time fighting poverty and increasing standards of living. I'm quite sure that the whole process will bring many success stories in the near future through mutual cooperation. Thank you.

Erhard Busek: Thank you, Mr Lemierre, for your comments and for describing this encouraging situation. I agree with you that the enlargement, in effect, is now reality. I think you will read a great deal about agricultural policy and other issues over the days to come, but the principal step has been accomplished. It has also been accomplished economically, if one considers the border regions of the candidate countries where huge investments have been placed. Finland played an outstanding role in Estonia; Sweden in Latvia; Germany in Poland and the Czech Republic; and Austria in Slovakia, Hungary and especially Slovenia. It is an ongoing osmotic process from the states of the European Union to the candidate countries. I must again emphasise that we need no new division lines. I think this is a danger. After removing one division line, we now have to aim for a comparatively open Europe for the future.

We have to rethink the concept of “Europe”. For example, if I am in Austria campaigning for enlargement and speaking about the importance of Slovakia's membership in the EU, I always tell my fellow Austrian citizens that the distance from Vienna to the Swiss border in the West is more than the distance from Vienna to Ushgorod. I should explain where Ushgorod is – it is a town in the Ukraine,

near the Slovak border. We lack knowledge of the new geography. The situation with regard to historical knowledge is even more striking. A famous Swiss journalist, Viktor Meyer, was working in the East for the *Frankfurter Allgemeine Zeitung*, a quality newspaper. He told me that at one time it was impossible to write about Slavonia in his articles, because in Frankfurt it was always changed into either Slovenia or Slovakia. Nobody knew that Slavonia is part of Croatia.

Economists are a driving force for obtaining such knowledge, and I am extremely grateful to Mr Lemierre for also mentioning South East Europe. I share his opinion on the events which occurred after the fall of Milosevic. The changes in Serbia are really outstanding. It shows how much can be achieved. As Special Coordinator for the Stability Pact, I can inform you that we are negotiating free trade agreements between all the countries of the region. At a time when CEFTA (the Central European Free Trade Association) is joining the European Union, we are trying to use CEFTA as an instrument in the future of South East Europe. It might be SEFTA - or whatever you want, the acronyms are not important - but the instrument of free trade is very important.

Moreover, we have an investment promotion initiative under British leadership, called Investment Compact, which should improve conditions to attract investment and ultimately increase investment levels. However, don't forget that it takes time to change mentalities. The events of 1989 are still quite recent. In some countries, the end of communism came even later. For example, the downfall of old Yugoslavia is quite recent. We are confronted with a lost generation of people who are now retired. There is a middle generation which finds it difficult to adapt to this new situation and a young generation which is jumping into the modern world quite quickly. Sometimes, I have the feeling they are more "modern" than their Western colleagues of the same age.

I will close my remarks with an anecdote. For three years, I participated in an EU programme for the re-education of Czech headmasters. It was an interesting experience. I delivered a speech in Olmuetz (Olomouc, Czech Republic) in front of forty-five participants and I told them what is written in the black book of education in the European Union: that the best should be compared, that lifelong learning using modern instruments is needed, and so on. It is quite a reasonable programme. After thirty minutes, I asked, "Do you have any questions?" No hands were raised. Then I spoke again for twenty minutes. I asked again if there were any questions and no one spoke. I was a little shocked and asked if there was something wrong. Was I difficult to understand? Are you interested in other topics? After what seemed like a very long time, one of the headmasters stood up and said very nicely, "Dr Busek, you have to understand that for twenty-five years, it was not advisable to raise questions. Why should I do so now?" Here we can see another problem which requires our comprehension.

The banks are a major concern in the countries of the region. As you know, Mr. Lemierre, I mentioned a working banking system earlier. You cannot do business without the right legislation, a working court system, and banks, especially for small and medium enterprises. I think small and medium enterprises need a good idea and a small degree of financing, and then they are able to start. Italians are renowned for this. For example, I have always been impressed with what the Italians are doing in Romania, or to be more precise, in Transylvania. Sometimes you have the impression it is a province of Italy. That is a very good example, so I am quite happy that the next speaker is Alessandro Profumo.

Alessandro Profumo: Many thanks President Busek, Ladies and Gentlemen.

I am very pleased that today's title is "New Europe". Perhaps we should have patented it, because it is a definition of the countries involved in European enlargement which Unicredito introduced two years ago when we created a division dedicated solely to these countries. In my presentation today, I will attempt to explain what "New Europe" means to us, why we have gone into these countries and the opportunities we see for development. I will also take up some of the points raised by the other speakers, President Busek and President Lemierre.

Mr Lemierre has spoken about "highly skilled" workers. What he said is very true. Certainly in these countries there was a system of government that none of us agreed with or approved of, which nonetheless invested heavily in human resources. There are many very capable individuals over there. Just to give you an example, during a visit to branch offices in Poland and Bulgaria, I was struck by the fact that the branch managers spoke English. Quite frankly, I am afraid this does not happen in our Italian branch offices.

Dr Busek has subtly addressed cultural diversity and touched on the need to understand and integrate the cultures of these countries with sensitivity. I still remember the first time we went to Poland. We made a few diplomatic *faux pas*, such as referring to Poland as part of Eastern Europe, for example. We were immediately informed that they thought of themselves as being part of Central Europe. Indeed, in 1747 they already had a Ministry of Education, which did not even exist in Italy back then. These countries have a strong national pride and feel themselves to be an integral part of Europe. For this reason we must be very careful and respectful in our dealings with them.

I always maintain that we as Italians have a phenomenal competitive advantage over any other European country when we do business with "New Europe": our strong propensity for successfully managing diversity. Ours is basically a very young nation, and our cities have very different cultural traditions and strongly held values. Anyone who manages a national company in Italy is well equipped to manage diversity. I always say that there is a much greater cultural difference between Bologna, Verona, Turin and Treviso than there is between Milan and London. This is the added value that we, as Italians, can offer to "New Europe". Certainly, we must be able to integrate ourselves in the most appropriate manner.

I shall say a few words about Unicredito in order to illustrate its role today and give some background on "New Europe". In particular, I would like to tell you about our established strategy, organisation and performance criteria as well as indicating the contribution that we, as foreign banks, can offer to assist the development of this area. The market capitalisation of the Unicredito Group as of 18 September 2002 is approximately 25 billion EUR. In the first half of the year, we had net profits of 850 million EUR, and a cost-earnings ratio of approximately 51%, the fifth largest of all European banks, with the first four all being British. Our pre-tax capital yield is a little over 33%, placing us in second position in Europe. Italians have the tendency to see themselves as separate from the rest of Europe, but the numbers I have just given you indicate that Unicredito is a fully integrated European player. Our after tax profit margin is 19%; and our tax rate is 43%. We have approximately 4,100 branches, of which 2,800 are in Italy and the remaining 1,300 are in Central Europe, which indicates the strength of our presence in that market.

Our holding company, Unicredito Italiano, has four divisions. The retail and corporate divisions contain companies which are totally separate from one another. From 1 January 2003, we will have a private bank, a corporate bank and a retail bank in Italy, giving us legal entities for each market segment. The retail and corporate divisions are exclusively Italian, but the private division has an Italian bank and also includes Pioneer, a global sales manager with a strong presence in Central Europe (We are market leaders in Poland, Czech Republic and Slovakia where Pioneer holds approximately a 20% market share) and a New Europe Division. So you can see that we have a particular structure which is totally dedicated to “New Europe.” This structure is important because we actually have two strategic levels: the holding company and the individual divisions. Roberto Nicastro is the manager of the “New Europe” division, and travels frequently throughout the area in order to identify opportunities for growth and creation of value. In this way, we are able to make a strategic contribution on two levels, which is very important because it gives us flexibility and increases the exchange of ideas.

In Central Europe we have a presence in Slovakia with Unibanka, a relatively small bank in which we are investing substantially in order to encourage internal growth, and in the Czech Republic, we have just bought Zivnostenka. We plan to set up a holding company which will manage both banks in order to create economies of scale between the Czech Republic and Slovakia. We are investing a great deal in the development of the branches in this area. We have a presence also in Croatia and Bosnia with Zagrebacka, a market leader with 36% of the Croatian market share and approximately 30% of the Bosnian market, and an excellent entrepreneurial base. We hold approximately 85% of the capital of Bulbank, the market leader in Bulgaria with a market share of approximately 26%.

We have had the good fortune to purchase a major bank in Poland, which as you know is the largest country in Central Europe with a population of approximately 39 million. Bank Pekao will form the cornerstone of our Central European strategy. We also have a presence in Romania with Unicredit Romania, a small operation which was originally a Turkish bank with 14 branches. Romania is perhaps the only country where our strategy is different. Whereas in all the other countries we aim to be the market leaders, in Romania there are approximately 10,000 Italian firms which we want to serve as well as various market sectors which interest us. For example, we will not take part in the privatisation process of BCA, which Mr Demiano has spoken about. We have recently received authorisation for Turkey and will shortly sign an agreement with the (Koç) family to purchase 50% of their financial holding company which will give us a strong presence also in this market. Then Pioneer with its Asset Management company is also present in various countries.

All of this has made us the most important bank in Central Europe. We are very large in terms of total assets, but above all we are the market leader in terms of net profitability, which is what interests us most, with approximately 6.5 million clients. In other words, we now have approximately as many clients in Central Europe as we do in Italy. Our group has almost 13 million customers, which I believe is a very significant figure for us. Also operating in the area there are KBC, a large Belgian bank and HVB, which is a major German bank, also following the incorporation of Bank Austria. It is interesting that the development strategy of these countries has been first initiated by banks from small and mid-sized countries or countries with little space for further domestic growth, such as Austria and

Belgium. The Italians have also been very proactive in these countries because we can see interesting opportunities for growth. Other banks with a substantial presence in the area are IntesaBCI, which you all know, Erste, a very capable Austrian bank, and Société Générale.

We can define as “New Europe” all those countries currently planning their entry into the European Union as well as Croatia, Bosnia and Turkey, and I must say that we are also looking at Yugoslavia. The most interesting feature is the data regarding the GDP per capita and the number of inhabitants in “New Europe” in comparison to the current EU member states. If we include Turkey, “New Europe” has 180 million inhabitants. Last night, the Minister spoke of approximately 500 million inhabitants after enlargement, not including Turkey, with a population of approximately 60 million. Excluding Turkey, roughly 25% of the European Union’s population, produces approximately 5.5% of its GDP. These numbers illustrate both the opportunities for growth and the problems of Central Europe, as the inevitable convergence of GDP will offer fantastic opportunities for investment, development and exports.

I am neither a politician nor a diplomat, but I am very pleased to hear that enlargement is now considered a reality. I have always been totally convinced that if the enlargement did not move forward in a fairly stable manner, we would have very large problems even in the existing part of the European Union, because it would mean that national egotism would have encroached on integration and development. It is extremely interesting for us to have an established presence in these countries, because they offer some very significant opportunities for growth. We expect GDP in Central Europe to grow consistently at a rate of between 3 and 6% in the next few years, in comparison with 2% in the EU. All the numbers associated with our profession with reference to GDP, for example loans to GDP, deposits to GDP, will have double levels of growth.

The opportunities for economies of scale and know-how transfers towards these regions are great. Italy is one of the top three countries in terms of international trading, and there are many possibilities for Italian Driven Business and the tax burden in these countries is lower than in Italy. Furthermore, the cost of equity is being progressively reduced. Approaching EU entry has obliged these countries to implement economic policies which have brought with them good practice in terms of public debt and inflation. For example, in Poland today, inflation is less than 2 %, a very low level. We believe that Central Europe will align their average per capita GDP with the average of the most recent countries to enter the EU (Portugal, Greece and Spain) in a relatively short time, offering many opportunities for development.

The mistake is often made of comparing “New Europe” to Latin America rather than other emerging markets. By analysing Moody’s ratings for countries and banking sectors, we see that, with the exception of the very particular case of Taiwan, all the countries of “New Europe” are much better placed than the countries of the Far East or Latin America. The spreads on government securities in “New Europe” as compared with “Latin America”, show that the markets clearly already appreciate this is a substantial difference. It is a key element because obviously every one of us must manage a risk-yield profile in our own business. It is important to inform investors that their risk profiles will not change dramatically. If we examine the process of negotiation with the EU on a country by country basis, we can see that this process is almost complete, except for Bulgaria and Romania which

will not participate in the first wave of entry. Clearly, there are still some extremely important formal steps to be completed before the end of the year and we hope that they will not be too substantial in nature. Thus, very soon we will be able to understand the entire process from an operative point of view. Romania and Bulgaria are working towards expected entry in 2007-2008, which must be followed very closely and encouraged.

These countries are not dissimilar in our view and have relatively similar dynamics and trends. Of course there are also differences, including the size and structures of industry operating in the various countries. We have developed a strategy with a particular focus on high net worth individuals and small and medium sized businesses, based on different market segments with the same business model and IT system. The management of a homogenous information system allows us to examine and understand the business in a more transparent way. We have already made many economies of scale and now we are implementing a card-processing structure in Poland not only for Central Europe but also for Italy. We have centralised all purchasing activities in order to align all prices to the best prices within the group and we already have proactive structures in place, such as Asset Management, Pioneer and leasing operations. We are currently examining a series of other areas in which we can create a European platform whilst retaining different brands and legal entities in the individual countries.

We also have a very strong planning and control department, which prepares all our information consistently. When I go to Poland once a month, I arrive at Bank Pekao at 8 in the morning and I'm able to read about the progress of Bank Pekao exactly in the same way as I read about any Italian bank. In this way, it is clearly much easier to immediately examine and understand the issues.

The large corporate segment does not present many opportunities, because it is where all the foreign banks have begun operating. There is strong pressure on margins and levels of risk are still very high. However, there are opportunities with small and medium sized businesses and high net worth individuals. Private banking is still quite limited, but we believe this sector will grow over time and are trying to decide which brand is the best to attract this type of client. For the general market, savings volumes are still very low and there is very intense transactional activity, which makes such clients unprofitable. We need to understand which of the general clients will over time become affluent private clients given the current high social mobility.

If we analyse the weight of the different banks from the point of view of profits, a relative problem emerges. Bank Pekao weighs heavily on the total group profits in the area, although this is quite inevitable, being that Poland is the largest country in the area. Poland has 39 million inhabitants and a GDP per capita of approximately 4-5,000 USD. It is followed by Romania with 23 million inhabitants, and a per capita GDP of 1,300 USD. Then there are countries with 10-12 million inhabitants such as Hungary, the Czech Republic, and others. Turkey, with 60 million inhabitants, offers the most opportunities, but has the highest levels of risk. One of the most intriguing aspects of Turkey is that approximately 20 million of its inhabitants live in three cities, so there is a strong population concentration which in a distributive business such as ours must be taken into consideration. Zagrebacka is also extremely important to us. Despite the difficulties of the past year,

Croatia nonetheless saw GDP growth of 3.5%. It is a country which will certainly grow rapidly and we look forward to following its development.

We believe that the governments of these countries have been very courageous by opening their principal banks to foreign privatisation. For example, in Croatia, a country with 4 million inhabitants, we have approximately 1.3 million clients, which represent a 36% market share, allowing us considerable influence in establishing the country's economic policy. We believe this trust has been repaid because all the privatised banks in the area have seen fantastic growth in profits, size, market penetration and reduction of operating risks. Furthermore, the spreads are very much reduced because the foreign banks have brought increased efficiency and thus the quality of business services has improved substantially.

We believe that this courageous choice has paid dividends for investors. However, there are still many things to do and everyone must do their part. We believe that the banks must continue to work to review credit processes, as the quality of assets is still a major problem in these areas. We must also invest in training and there is still much to be done in terms of product innovation, the export of innovative products from the West to these areas. Legislators and banking associations must work hard to improve the infrastructure. Currently there are not really any credit agencies, making it very difficult to adequately assess the merit of credit. The land registry system must be developed. In Italy we know that we do not have best practice as far as the land registry systems is concerned or for the recovery of guarantee credits. There are still very significant problems regarding the system of payments which we feel must be addressed. We must also review bankruptcy laws. The playing fields are not always level. In Poland, one of our competitors is a state-owned bank. Until one year ago, its obligatory reserves were much lower than ours. Yet an analysis of the financial structure demonstrates that Bank Pekao is less risky than our competitor. Furthermore, the legal system does not yet function perfectly. Where there is a problem which calls for enforcing guarantees or legal disputes between banks and clients or between banks and employees, the systems which are still in place look inadequate.

These are problems with which we in Italy are already very familiar and which exist to varying degrees throughout the Western world. Despite such issues, we are convinced that this is an area with enormous opportunities not only for banking but also for industry. Thank you.

Erhard Busek: Thank you so much, Mr Profumo.

I think it was very good to hear how the banking systems in general have developed and also to learn about Unicredito's activities. The background to this, which has to be mentioned, is that there have been very positive developments in security. Not only military security - remember it was not so long ago that we had military fighting - now we have closer co-operation between the countries in the region. Security in other fields is increasing through the existence of many aid programmes. It was also quite interesting to learn how the countries of the region are progressing. I think we should be aware of the interesting fact that Slovenia has a higher per capita income than some of the member countries of the European Union, such as Greece or Portugal. This is good for business because if people have money they will make purchases and apply for financing.

In a slight change to our agenda, I will open the floor now for questions and answers. Who wants to start?

Question: I'd like to ask a question about exchange rates. How does the bank see exchange rates?

Erhard Busek: Exchange rate, please, Mr Profumo.

Alessandro Profumo: The question is how do we see exchange rates? We have asked ourselves if we should cover the exchange risks associated with our investments and have decided not to cover them. We only cover exchange risks on profits because we are long term investors. Initially, we had cover, which we discontinued because it did not seem right. In our opinion, cover is required only on capital and not on goodwill. On an annual basis, we cover the expected net profit, so at the beginning of the year when we prepare the budget we do not have immediate cover for the expected profit or loss because we need to ascertain the company's final results.

Erhard Busek: Thank you.

Nani Beccalli: I'm really very pleased to be here today because this "New Europe" is of very great importance for General Electric. Indeed, it's extremely important for all major corporations involved in Europe. I've just returned from a trip to Hungary and Romania – two totally different countries for us, countries that present opportunities but are in totally different stages of development.

In Hungary we have 14,000 employees, which is the largest number of employees we have in any single country in Europe. We have invested more than 1 billion USD over the last 10 years, which is a considerable investment. We started in 1989 with the acquisition of the lighting manufacturer Tungsram and today these 14,000 employees represent 20 % of the total General Electric workforce in Europe, which totals some 70,000.

Romania is a country still searching for its way. It would like to become part of NATO, possibly in November of this year. As Mr Profumo has indicated, they are doing their utmost to fulfil the criteria necessary to become members of the European Union by 2007, and they are seeking foreign investment. They are desperately looking for companies to come over from the West - from Western Europe, from the United States - to invest and to help them create the infrastructure they need.

Let me describe General Electric's operations in Europe, the Middle East and Africa. The company produced about 28 billion EUR in European sales in 2001. We represent one-quarter of the total assets of General Electric, including the GE financial entities and the industrial businesses. Over the last twenty years, we have made 150 acquisitions, as General Electric has grown in this region mainly through this method. Over the past decade, we have invested five billion EUR and we have increased our workforce by about 85 % over the same time period.

What we see in this "New Europe" is an excellent place for the future, with a highly skilled workforce, advantageous cost arbitrage and a strong government commitment to work towards growth

and empowerment. However, this enlargement also represents a certain number of challenges for all of us. It represents challenges for the companies that are going to invest and for the government. We believe that the creation of the right environment must take into consideration three important elements.

Number one is the evolution of a single European market. I think this is fundamental, particularly in areas such as infrastructure, energy, transportation and financial services. It was very interesting for me to listen to Dr Profumo's presentation, because in some areas we are competitors and we face the same kind of problems. A true single market is critical for the creation of an engine for growth. The enlargement of Europe, this united Europe, can go East with the countries we have discussed, but we must not forget the possibilities in the South. I happened to hear a presentation recently by Romano Prodi, who was talking about the possibility of creating a buffer zone around Europe, making sure that there is a core European economic entity. I think this is a very interesting concept. You are also helping to create a buffer zone that should include the Mediterranean area, by which I mean North Africa, and Russia. In his speech, he spoke of Russia not as a member of the European Union, but as a potential satellite country. It is difficult to define Russia as a satellite country, but in this instance, I mean as a satellite of the entity we call Europe.

A third important point for consideration is the common currency, the Euro, which is now physically in the hands of 300 million people, and is really helping us to understand how easy it is to trade and do business today. In 1977 when I started working for General Electric as a young employee in our facility in Holland, I would travel across Europe to visit my parents in Turin in my little Fiat 127. I had to have an enormous wallet because in those days service stations did not often accept credit cards and I had to carry enough currency to be able to purchase petrol and food over fourteen or fifteen hours, using a variety of currencies. Today I can leave from Brussels, my place of residence, and arrive in Turin using my credit card, of course, but paying in one single currency. This is not a serious example but it demonstrates how our life can be made easier by the Euro.

A stable, pan-European single market is extremely attractive to inward investors. It's extremely attractive to American companies, or American-based companies like General Electric that want to invest in this area. Currently, General Electric is making a tremendous effort to expand in Europe, the Middle East, and Africa, because we believe that is going to be the next frontier of growth, together with China. At the European level, we support any measure that will offer investment protection and increase business confidence in this enlarged market. We are looking for liberalisation and privatisation opportunities as well as social stability and a body of legislation to protect our investment, together with the possibility of sourcing talent. These are the elements that make a country particularly attractive for investment.

It's not so much the presence of a market within the actual country. Hungary, the example that I was mentioning before, is not a big market by itself, but it is a country that has created an extremely favourable environment for General Electric's investment. We are exporting 99 % of what we manufacture and produce in Hungary.

We have successfully participated in eight major privatisations in Europe and for the time being we have been extremely successful and we are very happy with such privatisations, like the one in

Hungary. Another successful privatisation is Nuovo Pignone in Italy, which has become a global business and one of our most productive Italian companies. I'm not trying to compare Italy to Eastern Europe, but there is a technique, or method, for successful privatisations which is helpful.

China is also going to be a major power in the world market. It will be a commercial power in a relatively short period of time. It represents 1.2 billion people working very hard, creating tremendous opportunities. I travelled to Shanghai seven years ago, and again about one year ago. In those six years, the city of Shanghai had changed completely, from an old-fashioned oriental city into a very modern metropolis. Why am I saying this? I am saying this because the only possibility that we Europeans have to counter China in the future, and capitalise on its market is to work together. We must be united and we must expand until we are large enough to compete.

The expanded Europe, the 500 million people Peter Hain spoke about yesterday, will provide a group of consumers even bigger than the American and Chinese markets. Even if there are 1.2 billion inhabitants in China, their purchasing power is limited compared to that of a 500 million Europeans. We are going to gain this power if we really create a single market in united Europe. It can be exercised at various different levels, for example the WTO and other agencies, and it is going to increase European influence.

Eastern European countries have attracted investment over time through subsidies and aid. It is important that the rules discussed and agreed in the past be maintained during the process of European enlargement. In order to participate in the European Union, some of these countries which have reached agreements with companies like General Electric may have to rescind such agreements. This would be wrong. We have to ensure that the European authorities are sensitive to this particular issue because an investment decision in a country is a profit and loss decision. The profit is determined by how much you are going to sell, how much you are going to support, how much help you receive from the government, and what your costs will be. If elements of this equation do not add up, the investment decision will be reversed. Our company, like many of yours, will change direction and invest elsewhere. China could represent an opportunity.

We strongly believe that our consumer businesses should benefit from the level playing field created by the Euro. We expect this single currency to encourage consumers to shop around for the best products and the best services at the best price, which is going to make all companies much more competitive and capable of offering the best products at the lowest cost. We believe that competition is a primary engine behind progress, as all of you know well. It is going to make us improve our technology, increase our output and become much more productive.

When we were making preparations for the Euro, everyone's attention was concentrated. Now that we are there, many other issues have come to the fore regarding the formation of this new, more complex Europe. For example, the workforce has increased mobility. I found myself closing a headquarters here in London at the beginning of the year and opening one in Brussels, and I had to transfer some employees from London to Brussels. They were neither English nor Belgian, and it was an absolute nightmare. It turned out to be very expensive for the company because the fiscal and pension policies are not harmonised or coordinated and the company has to contribute in order to ensure employee satisfaction. This issue must be corrected. As soon as we solve one problem, we

immediately find ourselves facing some other new problem which is just as important and also requires our attention.

The creation of a single market for 500 million people represents a challenge for our institutions. We hope that the commission led by President Giscard d'Estaing will be successful in creating what I would call the constitution of the "New Europe": a simple and easily understood document to help the countries converge, rather than continuing as a loose configuration like we have today. This is needed in order to ensure that there are clear decision-making processes and that such power is in the hands of the appropriate authorities.

It is also important to observe that a company like ours, which in the 1990s desired independence from government, now believes that we will have to work much more closely with government from an economic, social, political and global perspective. We are trying to create something in Europe which is greater than the sum of its parts. The private and public sector must be better connected and they will have to co-operate much more closely. I believe that this trend will continue over time.

We must also ensure transatlantic co-operation between the United States and Europe. Before I spoke about strengthening Europe, I mentioned that with 500 million consumers. Europe will be a strong and powerful voice in the WTO and similar institutions. We must take this opportunity and ensure that peace and normal trade across the Atlantic. No one gains from a trade war. A company like General Electric produces on both sides of the Atlantic and exports not only from the United States to Europe, but also from Europe to the United States. We find ourselves caught in the middle, so it is important to continue to place emphasis on dialogue.

These are a few of the considerations that we at General Electric have regarding the "New Europe", and the enlarged Europe that we are going to form in 2004. I thank you very much, and I thank Mr Simonelli and Mr Busek for having given us the opportunity to make our presentations in this forum. I would be glad to answer to any questions that you might have. Again, thank you very much.

Erhard Busek: Many thanks, Mr Beccalli, for this important contribution. It was quite interesting to listen to your observations from the point of view of a global company. We are currently undertaking important work on a regional electricity market in South East Europe, to bring the region closer to the European Union and integrate the internal electricity and energy markets. Bulgaria and Romania have joined UCTE (the Union for the Coordination of Transmission of Electricity). This is the Western system and has great importance for the Black Sea and Caspian Sea area, because there are many unanswered questions regarding energy. Thank you also for mentioning your personal experience of past European travel. Of course it will happen again not quite from the date when these new countries enter the European Union, but hopefully soon after. They are trying to improve and I think it is a big advantage, similar to the Euro zone, and one of the speakers is, as far as I know, quite in favour of this. Last but not least, I think we need a Euro-Atlantic perspective. There have been problems of late, but I truly believe we can work together, because we have a common responsibility. Therefore, many thanks for mentioning this principle.

The next speaker is Luigi De Puppì. Benetton requires no introduction. I would ask the colours of Benetton to take the floor.

Luigi De Puppì: Thank you. It is an honour for me to be here with you to discuss a very important topic, a topic which certainly concerns us, but which will concern us all also in the future and our children.

I have taken the liberty, at least in my mind, of changing the title of our London panel from “New Europe” (the “promise”) to “True Europe” (the “mission”). Indeed, “New Europe” has already moved on from the fall of the Berlin Wall. However, we are still waiting for the next step, “Real Europe” (the “vision”), which I believe is the final stage of a mature and experienced integration.

In less than ten years, we have already reached the brink of EU enlargement. We are now discussing the impact and implications of the Euro outside the countries adopting the single currency. We are facing different tendencies in the restructuring of international economy and finance and asking ourselves about the nature of the unfavourable global economic climate, the collapse of American consumer confidence, and the worries of the Europeans. We all look forward to the awaited upturn. The question is: When will it arrive and will it be like anything we have seen before? Business cycle theorists believe that we are going through one of the historical waves of economic activity and change and that there is nothing new under the sun. I find this opinion a little too “good to be true.”

By the same token, it is very difficult to speak about the future of Europe without being influenced by my Italian identity and without being aware of the evolution of the global economy and recent international events. When examining the “legal dimension” of globalisation, we are immediately faced with our consistent marginalization. Despite the benefits of joining the “Euro”, Italy still suffers from many well entrenched problems of the past, as does Europe.

A recent report on “Modernity and appeal of the Italian system”, from IntesaBci and Studio Ambrosetti, presents an alarming profile of our productive system, which has lost market share more rapidly than almost any other industrialized country, falling from 4.23% in 1980 to 3.53% in 2000. We are ranked last in capacity to attract foreign direct investments, especially for research and development. From 1996-2000, Italy absorbed only 0.55% of total world investments and a meagre 1.02% for research and development. In a OECD area ranking, only Spain performs worse than Italy.

Europe is suffering in the global competition of high tech production with a 25-30% negative differential towards the United States and Japan. Italy is lagging behind leading European countries in the technology sector, such as Germany (20-25%) and France (12-15%), and faces competition from rapidly-expanding emerging countries with middle-low technology. A similar trend can be observed with reference to productivity, which is much lower in Europe than in the United States.

Another important point for consideration is the size of the Italian/European companies: around 50% of the Italian workforce is employed in companies with less than 10 staff (over 90% of Italian firms); whereas this figure is only 20% in Germany and 30% in the UK. Indeed, 65% of American workers are employed in companies with more than 500 employees, compared with 43% in France, 50% in UK, yet only 15% in Italy. Unemployment and infrastructures are also difficulties in

Italy and Europe and the crux of the problem is youth unemployment. The most negative impact is exerted by inflexible labour conditions established by the European trade unions.

In addition to these factors, administrative burdens are a real obstacle to the evolution of the Italian economic system. We hope that in future this disease will not spread to the rest of Europe. In the competition between the most important global players in industry, Europe has to bring its economy back to growth through more flexibility, less bureaucracy, and innovative investments. In my opinion, one of the reasons for moving industrial production from the West to emerging countries is not only the obvious benefits from lower labour costs, but also a very high degree of flexibility and freedom for the entrepreneur. Some of the following considerations on Europe come from the 7th Report on the Global Economy and Italy. It is difficult to compare the American and European economies because of differences due to the following factors: Europe has a declining population, its average age and the density are higher; Europe lacks natural resources; the environment is more delicate and vulnerable; such critical issues oblige Europe to act differently from the US; European firms have to face up to some of these problems; the European economy has to compete with America and Japan as well as other powerful emerging economies such as China and Korea.

The only solution is to launch a development model based on advanced competence and innovative technologies. Economic success can only be achieved by a rapid increase of our national appeal to both internal and international investors. Indeed, new sectors such as robotics, aerospace, ICT, aviation, advanced pharmaceutical products, microelectronics, and new materials do not perceive the Italian industrial system as having sufficient international standing.

I do not agree with those who conjure up the ghost of September 11 in an attempt to find emotional reasons and inconceivable or mystical explanations for the current economic and financial situation. There is no doubt that we will remember this day for a long time to come, and we all know it has shaken the international order. The distinguished participants in this conference will remember that Wall Street was in free fall before these events. In the Spring of 2001, the speculative bubble was beginning to burst before our eyes. The high-tech component of the stock market and even the more consolidated equities started reporting huge losses. Yet still the dance on the Titanic went on, without anyone listening to Admiral Greenspan's warnings.

The business community was expecting an upsurge after months of negative symptoms. The international central banks proved to be stronger than supposed but industry, consumer confidence, and international investments were down. Indeed, there were other fundamental woes in the world economy. It is not by chance that new multiyear lows have been seen again in Wall Street and in the most important European stock exchanges. We could take the past week as an example and there are rumours of possible further downward revisions in the immediate future.

I am perfectly aware that here in London, just around the corner from the City, my viewpoint might be seen as purely defensive and sceptical, focusing on such negative aspects of the international economic outlook, but I really believe the situation to be rather complex. However, I am confident that we are in the midst of a change of unprecedented dimensions in the structure of the international productive and financial system. Technological innovation and the terms of trade in future competitiveness will prevail with their sweeping force and allow us to forget the bear market. Despite

the current negative climate, Europe has launched its single currency, the Euro. It is still too early to formulate a definitive opinion, but it seems that the Euro is one of the few success stories of 2002.

In relative terms, the new single currency has almost completely replaced the German Mark. In Eastern Europe, transactions in Euros have significantly increased and in the international bond markets Euro issues have doubled from 10% to 20% of total issues. In some countries of South East Europe like Turkey and Croatia, not to mention the special circumstances of Serbia, Montenegro or Kosovo, the Euro has become the primary foreign currency referent and even in Israel it is highly welcome.

In any case, the fundamental aspects of economic and financial influence of the protagonists of the world economy have been turned upside down. Despite a negative economic performance (not to mention a foreign trade balance in the red), the United States maintain their lead position and the dollar is the currency of reference outside the USA at a ratio of 55 to 65 %, in Latin America and Russia, the two most important “dollar regions”. The Euro, the single currency of 300 million Europeans, is today the currency of reference for only 7-10% of other countries. There is, however, fast growing acceptance at a competing level with the dollar, not only from those who hide their money cautiously under their bed, but also private and institutional investors. The figures I have quote are confirmed by ECB experts.

The relative sizes of the major economical players must be taken into account. China’s GDP is over 1 trillion USD, in comparison with American GDP of 10 and a Japanese GDP of 4. The so-called future “Real Europe” will encompass the former separated “brothers” already prepared for entry. Later, the enlargement will involve the Balkan. Then even Russia may join, probably in a kind of special partnership. This progress is already perceived as irreversible. This “Real Europe” has a GDP of approximately 9 to 10 trillion USD, roughly equivalent to that of the US. Euroland alone had an estimated GDP of more than 6 trillion USD in 2001, whereas the G7 countries account for 68% of global GDP.

As the international and strategic situation deteriorates, the EU still lacks competitive governance and concrete convergence on crucial issues. The lack of clear strategies results in a general sense of uncertainty. By the way, we are talking of variables that very often are not measurable. The major players, the United States, Europe and Japan, are supported by their own primary areas of influence:

- USA: NAFTA, Latin America and the Pacific Rim;
- EU: enlargement with an additional 5 to 10 members, influencing Central/Eastern Europe, Eurasia and the Mediterranean;
- Japan: specific economic reference in Asia and the Far East.

We can see the aggregation of regional interests through the powerful bridges formed by innovative technological networks. Today’s global situation is like an archipelago which continues to grow. Financial flows demonstrate these different realities. As President Bush said recently in Peking, “Diversity is not disorder; debate is not conflict; disagreement is not revolution”. Day by day, citizens and enterprises discover that we are all interdependent. No one can act separately because we all live in

an integrated system and we must become accustomed to it. Only “culture” and “common understanding” can speed and direct this process.

The real economy and finance are not two separate entities. They live together in systematic, daily and indefatigable contacts, forming the coordinated capitalistic system in its revised version. The real economy is the emblematic framework for income circulation, accumulation of savings, labour, investments and it is the field where technological innovation produces its excellent results, and together with the tidal waves I have already described.

Some weeks ago, the President of the European Central Bank, Willem Duisenberg, evoked the great economist and founder of the Vienna School of Economics when he stated that “Joseph Schumpeter has influenced economic thought by introducing innovation as a source of economic dynamics. According to Schumpeter, economic development was a dynamic process, a disturbance of the economic status quo. The real challenge for capitalism, therefore, was to create and destroy economic structures in a process he called “creative destruction”. This was the essence of economic development, a process defined by entrepreneur’s implementation of new production combination”. He continued, “I believe that Schumpeter would be very interested in the Euro as a catalyst for integration and competition in EMU or rather economic growth and adjustment in the Euro area. Both high, sustainable economic growth and the ability to adjust smoothly to changes in the economic environment require further economic integration and competition.” To summarise, the “Real Europe” urgently requires:

- political development in tandem with economic development;
- careful observation of not only the “Global Consumer” but also the “Global Citizen”;
- a higher degree of flexibility;
- diversified market growth at a different speed of development;
- common culture, innovation, and the creation of a helpful and positive environment for business, which must be supported at a national and European level in order to create added value and be more competitive.

When we speak of common culture, we must assume an upgraded common and international “juridical entity” above the European dimension, as well as a common approach and accepted procedures set out by well-recognized institutions rather than bureaucracies. If Europe becomes the sum of the weakness of each country, the “vision” will fail. International vision, direct investments, competition and innovation are conditions for facing EU enlargement in a positive way. The positive impact of enlargement will not be developed without decisive government reforms. Transition is important not for the countries which will enter in the EU in the coming years, but also in current European Union member countries, including the United Kingdom, which must make a decision about the Euro.

“True Europe”, the future of “Real Europe”, is therefore a crucial challenge for the global system. It must be discussed in managerial terms corresponding to our immediate experiences. I share the opinion expressed today by the Special Coordinator for the Stability Pact for South East Europe, Erhard Busek. The East is not a single, homogenous unit, but rather a variety of diverse regions. This

is both a benefit and a point of weakness in terms of integration. All the countries want it immediately, at almost any cost and without any hesitation. We have to take a medium-long term view, or we will create disadvantages rather than development. Indeed, the countries of Central and South East Europe seems to demonstrate the same signs of crisis that has flattened the GDPs of industrialized countries as globalisation creates interdependence.

Following a satisfactory performance by the transition countries in 2000, growth slowed down in 2001 as the external conditions deteriorated. This tendency has been confirmed in the first quarter of 2002. Industrial production has weakened and in some countries it has even declined. Expanding consumption has been the major growth factor as capital formation weakened or contracted. This does not bode well for economic growth in the medium-term. The contribution of foreign trade to GDP growth could be neutral by the end of 2002, with the exception of the Czech Republic and Hungary, where external conditions may result in a more positive picture.

The evolution of competition, together with industrial and trade specialisation in the Central and Eastern European Countries (CEECs) is at the forefront of our investigations and forecasts. It has been demonstrated that the CEECs have taken very different paths. Both catch-up and trade specialisation models are required to understand the patterns of specialisation emerging in Central and Eastern Europe. Regional differences are not dissimilar to international differences. Some regions are catching up in terms of industrial up-grading and they are very successful in attracting FDI which accounts for a large share of overall exports. Other regions remain “locked in” to low-skill areas of production, with low numbers of well-educated personnel and little opportunity for up-grading. Regional differentiation thus constitutes a great challenge for cohesion policies in the candidate countries. I wish to conclude with a quote from Alan Kay as my wish for the “True Europe”: “The best way to predict the future is to invent it”.

Erhard Busek: Thank you so much, Mr De Puppi for an outstanding speech on the global approach to economy and business, which has a great deal to teach us on a political level. I think politicians can make an enormous contribution to this global approach. It is sometimes more difficult because Benetton is a well-known global brand. Many thanks also for mentioning that unity and variety are one of the challenges. I think it is sometimes difficult to accept others, and many problems arise from this, yet we are enriched by diversity. Indeed, it would be horrible if the only food available in the world was a mass-produced hamburger. I think we need variety, not only in the kitchen, but also in culture, landscape, and so forth.

Thank you also, Mr De Puppi, for mentioning Schumpeter, as he is an outstanding example. He was a great economist in the period after the First World War, although he was not a very successful Minister of Finance in the Austrian Government, but that’s another story. However, few people know that Schumpeter began his academic career at Czernowitz, as it was called then, a city of the Austro-Hungarian Empire, later known as Cernimcy under the Poles and Cernauti under the Romanians, now Cernifzi in Ukraine. Yet it was always the same city. We may have different names for the same place, but it remains an integral part of Europe.

I think now we should hear the views of a politician, so please give a warm welcome to the Rt Hon Peter Mandelson. I am delighted that he can be with us today and I shall now ask him to take the floor. Thank you.

Peter Mandelson: It is a great pleasure to be addressing you this morning. Indeed it's always a pleasure to do anything with Italy, Italians, Italian food, and Italian clothes. This famous love affair between our two countries has gone on for a very long time. I mean, at least our love affair, I hope it's reciprocated.

I'm pleased to be here to talk to you, but I will not speak about the economics of Europe, or make the business case for Europe, or indeed advocate economic reform in Europe. I do all of these things continuously ad nauseam. I'm going to do something else today. I'm going to talk a bit about politics, which is probably appropriate given that I'm a politician and not a businessman. However, I very much agree with what the previous speaker was saying. In the last few years since I've been in government and out of government, and in government, I've had constant debates with my friends and opposite members on the continent about what sort of economic and social model we want in Europe. Well there is no single model or blueprint, to be rolled out across the continent. I think that in a sense, in the sort of debate over the Rhineland versus the Anglo-Saxon economic model, probably we in Britain have a little to learn at the social level from the Rhineland model – not too much I might say, but something. I also think the Rhineland model has something to learn from the Anglo-Saxon ways and methods of doing business. I don't want to do anything to destroy or rip the social heart out of Europe, but I do passionately believe that we need to bring more economic dynamism to Europe. We need a little bit more American style economic dynamism in our continent, if I can risk straying into controversial areas with a mention of America at the moment. In any case, I think these models are converging somewhat, although I also happen to believe that the centre of economic gravity on the European continent is moving more towards the Anglo-Saxon than the Rhineland and I think that's good.

Now, let me talk about institutional changes, and Europe's future, about politics and about Britain's role and about our own and my own approach to these matters. In my view, Mr Chairman, Europe is at an important crossroads this autumn. Gerhard Schroeder has just won his re-election. I welcome that for Europe's sake as well as Germany's. For all Germany's deep economic problems, I still believe that Mr Schroeder has the best chance of modernising Germany and carrying forward the reforms that we need to see in that important economy. At least I keep my fingers crossed for that.

Moreover, I think his re-election ends a period of immobilism in European policy, and mobilism, more than anything else, is what Europe urgently needs. We are stuck. We have stayed still for just a little bit too long as we have waited to get through the period of French and German elections. And I think that mobilism that Europe needs to show must happen within a new framework of principles to govern the European Union's institutional development. The challenges that Europe faces over the next two years are as great as at any time in the Union's history: rebuilding the strained transatlantic relationship; managing enlargement; reviving Europe's economy to ensure the success of the single currency; the shaping of a new European constitution.

I believe that Britain has a crucial role to play in meeting these challenges, and that in the years ahead, Britain could give real leadership in the European Union. We have a strong economy and a quality of armed forces without which any European defence capability is pure wishful thinking. We in Britain are at the pivot of the relationship between the United States and Europe. And with Europe about to enlarge, I think Britain has a more natural rapport with our new partners and certainly less historical baggage than many other present member states.

Most of all, with Tony Blair as Prime Minister, we have now the most committed pro-European to hold that office at any time since Edward Heath was in Downing Street. Tony Blair is in a position of unparalleled political strength in the position which he holds today and for the foreseeable future. The opportunity to lead, therefore, presents itself. There is no shortage of political affinity in Downing Street for a project of such political significance as the refashioning and reshaping of Europe. The issue facing Britain over the next two years is whether we have it in us to seize this opportunity to provide the leadership that I think our country needs to offer to others. It should be obvious that Britain can contribute in this way. So what is the doubt?

Let me be clear about this. This is not at its heart a question of the government's stance on the Euro. I am a strong supporter of the policy Gordon Brown and Tony Blair have set out. Yes in principle to the Euro, but the economics must be right. Of course Britain's membership of the Euro is fundamentally an issue of politics and whether Britain is serious about its destiny as a fully committed member of the European Union. Yet the economics are also crucial in order to be certain that the economic impact of joining will be positive, both for Britain and for the other Euro zone members. We cannot sacrifice the economic stability that is the Labour government's most impressive achievement since we came to office in 1997 and I don't believe that you or anyone else would expect us or want us to do anything to jeopardise the economic stability which we have so painfully and carefully built up.

The only way to win a referendum in this country is for the government to be able to argue with conviction that Britain's Euro entry will be good for jobs, for prices, for investment, in other words the fundamental building blocks of our prosperity. If it can be argued credibility and confidence that entry is in Britain's long-term interests, then I believe that we will win the referendum, whatever the opinion polls say today or whenever the government announces the result of its economic assessment, which we know needs to take place before June of next year. Fudge the economic tests before a referendum and we would assuredly lose it. That's the importance of the assessment and of the tests that the government is applying.

However, my central concern today is not actually with the Euro and Britain's joining the single currency. It is a wider debate about Europe's future and a complacency I fear in Britain's attitude to Europe. Too many people in this country feel that it is enough for the government simply not to be the Conservatives. It's actually very easy not to be the Conservatives. As long as you're not the Conservatives, you know you're okay. The Labour government can afford to rest on its pro-European laurels and rely on the undeniable fact that, unlike the Tories, it wholeheartedly supports British membership of European Union, and thereby limit its activity.

Today it is clear that that is not enough for the British government to rest on. The challenges we face in Europe are such that just being better than the Conservatives is not good enough. It no longer suffices to play the tunes of the 1970s – look how good Europe is because membership of Europe’s single market is good for jobs and prosperity. Of course that remains true. Of course the single market is absolutely central and essential to building prosperity and a generation of jobs and investment. There is a European reality that too few people in Britain have come to terms with. We need the European Union to move on, to build, to evolve without standing still, to respond to new challenges facing our continent and all our peoples, and this in turn requires further integration between the member states.

Just look at how the argument has moved on immigration and asylum within the space of ten years. The British concern was to limit the EU role and protect our national border controls. We are an island, we are insular and we look after ourselves. If there’s a problem, we will erect border controls and then we will be safe. What nonsense. Today Britain recognises that there is no way that we can cope with the pressures of asylum without a common European policy, and the UK is an advocate of majority voting to achieve that policy. Now my proposition is that this is just one example of how the pro-European stance of Britain’s Labour government has to move up several gears and develop a credible strategy for shaping this new integration in Europe. We need to persuade our partners in the Union to apply greater rigour to defining the European Union’s future role and identifying priorities for reform, chiefly but not exclusively economic reform. I think of the Common Agricultural Policy as well. We must create new ways of conducting business in Europe and linking the European Union’s decision- making more closely to the democratic structures trusted by citizens within the nation state.

As the Prime Minister has indicated, I believe our guiding principle should be more integration and shared sovereignty in Europe, driven by practical needs, not political dogma. That integration must be rooted in the democracies of our member states and that should be our guiding principle. That should be our compass in shaping Europe’s institutional development. We need more integration and shared sovereignty, rooted in the democracies of our member states.

What does this mean in practice? It means Britain making imaginative proposals for where we want Europe to do more, what exactly we want it to do, and how it should be done. For example, if Europe is to become a more prominent global player to complement the United States as an effective and more equal partner in international affairs, then the machinery, personalities, and coordination of the European Union’s common foreign and security policy need to be strengthened, whilst obviously remaining firmly under the control of national governments.

A European Union high representative in international economic affairs would enable Europe to assert itself more in the world’s financial institutions. At the moment, in the World Bank, the IMF, and other places, people who sit on Capitol Hill in Washington have more influence and impact on those institutions than the combined weight and influence of the European Union and that’s wrong. Expanding Europe’s defence capacity within the NATO framework means each member state spending more on defence assets and forging the resolve and the dependable decision making practice to use those assets to good effect.

Mass migration, as I've already said, is a big current challenge facing European governments. Europe's 2004 intergovernmental conference will take crucial decisions on immigration and asylum and how we can manage migration so as to benefit ourselves economically and socially, while policing our common borders in a fair and transparent way. In relation to cross-border crime, protecting the environment and combating drug trafficking, we have to determine what more the EU should be doing so that it focuses on the big trans-border challenges while avoiding unnecessary harmonisation, or unnecessary and excessive regulation within Europe.

This means advocating a new constitution for Europe, radically simplifying the labyrinthine and incomprehensible treaties that currently exist. With the exception of core sovereignty issues such as tax, war and the constitution, we should also embrace a general extension of qualified majority voting so that we can overcome the reform paralysis that will set in if we are not careful when enlargement happens. It also means strengthening, not weakening, the commission's powers as an independent executive. For it is a politically led executive and not just a civil service. It's not just a bureaucracy as people like to claim. It provides an essential motor, for Europe attempts to create an even playing field for all. Especially in an enlarged Europe, the single market would fall apart all too quickly without a strong Commission. We need the Commission to hold that single market together.

However, if Europe doing more simply means its central institutions having more power and taking more and more into the centre of the European Union, and Brussels having more reach, doing more in more areas of activity and governmental concern, then we will be guilty of confusing ends and means and, what is worse, digging the European Union even deeper into the democratic and credibility deficit that currently engulfs it. Therefore, in designing the new Europe for the new century in which we live, we need to be clear about the EU's true role. It is not an alternative to nation states. It is an aid, a means of enhancing what nation states do for themselves, but can do better by cooperating and working together.

The Commission is an executive, as I say, but it is not a substitute for national governments. EU institutions should have adequate powers and leverage to enforce decisions and legislation with recalcitrant member states. However, the policies and priorities of these institutions should exist within the framework and a strategy laid down by the member states own representatives because that gives the EU roots in the recognisable democracies and democratic structures of the member states, and therefore gives those self-same EU institutions legitimacy in the eyes and the minds of our citizens that those institutions need in order to perform better in the future. It's legitimacy that the EU needs, and it will get it by rooting what it does in the democracies of our nation states.

The fault line emerging in Giscard d'Estaing's Convention is not between federalists and inter-governmentalists because that balance, that trade-off, has largely been resolved. That fault line is instead between centralisers on the one hand and democratisers on the other. Those of us in the latter camp, who define ourselves as democratisers in Europe as opposed to centralisers are prepared, and we want to see the EU do more. We want greater integration and shared sovereignty, but want this made more popularly understood and accepted across the continent by ensuring the EU's direction, its mandates, its information, its public accountability flow from, to and through the member states' own democratic institutions. This means a greater role for national parliamentarians to complement that of

the European Parliament. It means a consistent enforcement of rules of subsidiarity in the EU. That is what can be done by member states, what should be done at the national level and only what is better done at European level should be passed upwards to that level.

It should also mean representatives of national governments having a closer day-to-day role in managing the EU's business with a permanent political head of the European Council; collectively they, and on a continuing basis sitting as a legislative council within the EU, would resolve the inevitable issues and disagreements that crop up between members and ensure that a European perspective prevails alongside the interests of each nation without a logjam of housekeeping decisions accumulating and then swamping the agenda of the heads of government meetings. These things can and should be sorted out on a day-to-day basis but they need the permanent intensive engagement of representatives of the national governments in Brussels. It would also give the EU a high-profile public face in speaking to the rest of the world so that Europe stands up, holds its head up high, is listened to and recognised appropriately right across the globe.

Let me just say this in conclusion: I want to see the British government doing more to present its distinctive ideas for a progressive, forward looking, democratic European identity. Those ideas undoubtedly exist. They have been articulated by the government and they are gathering support in my view. We as a government were reluctant to offer too many targets for the anti-Europeans when the government first came into office. My firm belief now is that any lack of courage by the British government that was excusable in 1997 is not defensible in 2002. So these remarks of mine should be read not as a criticism of the British government, but as a wake up call to Britain as a whole. EU enlargement, renegotiation of the EU budget and of the common agricultural policy, strengthening the economic policy framework of the Euro zone, the defence and foreign policy challenges, they are all issues on which the British voice could and should be heard more. I am confident that we will hear that voice in the months and years to come, and I believe in all modesty that the EU will be the better for that. Thank you very much indeed.

Erhard Busek: Thank you very much to Peter Mandelson for his positioning of the British Government on the one hand and expressing the European commitment of the United Kingdom on the other hand, which is certainly important with regard to the leadership role Great Britain always takes at this crossroads of Europe.

I have already mentioned that, also on behalf of South East Europe, we are pleased that on 24 November there will be a conference on organised crime here in London. It represents a commitment to strengthening Europe in different fields. I think Peter Mandelson's political approach is very important for our conference today, illustrating the current political environment, because it makes no sense only to focus on business and economic development, without looking at what is happening in other fields.

Thank you also for expressing a clear point of view concerning the development of Europe, because politically we have to develop. Economics develops in a globalised way and the continent of Europe through enlargement will become a single economic area. However, it is also necessary to build up the political framework, and therefore many thanks for your remarks, Mr Mandelson.

Now, following our agenda, we have the opportunity to raise questions. I would like to ask for questions from the audience, because I think there are a lot of questions generated by the speakers.

Question: During the past ten years of the economic cycle, during expansion, that the economy was characterised by mergers, acquisitions, cross-border merger-acquisitions, investment in Latin America, and the assumption that the fastest if not necessarily the easiest way to increase market share was to expand through merger-acquisition. Now, during the downturn in the economy, we are ready to de-merger, dis-investment, and spin-off. Many financial institutions have announced that they are abandoning Latin America. In this discussion today about “New Europe”, do you envision a situation where after the moment where the new Europe attracts a great deal of investment because of the high return, strong GDP growth? Once this situation stabilises and interest fades somewhat, do you envision a situation where there will again be de-merger, dis-investment, spin-off from “New Europe”, and what is going to be next?

Erhard Busek: Thank you. Another question?

Question: I have a question for the panel. Among the many positive things that have been said, one in particular struck me: the difference in productivity between the United States and Europe. Indeed, if we look at it from the point of view of GDP, we see that, as Mr De Puppi said, in order to reach the same levels of GDP as the United States, we need twice as many people. I wanted to ask if it is possible to understand where the roots of this difference in performance lies, in economic terms, between the United States and Europe because the “New Europe” of enlargement will be built in the image of what we can call the Old Europe, the Europe in which we are living at present. Thank you.

Question: Could I please ask Peter Mandelson if he could confirm what I’m often asked, that if the British government does give a strong lead before a referendum, the British people would actually fall in line and vote positively? Secondly, within an imaginative approach to sovereignty, the present union includes eight kingdoms and seven republics, and more republics will enter. Would you like to make a comment on that particularly, in the context of the Giscard constitution? Thank you.

Erhard Busek: Thank you. Anybody else? Then I think I may ask Mr De Puppi and afterwards Peter Mandelson to answer on behalf of the panel.

Luigi De Puppi: You have understood exactly why I felt compelled to state that Europe must not repeat the mistakes of the past but rather make an effort to be more aggressive and innovative. However, it is quite difficult to respond to this question. There are two interrelated reasons why the GDP of one country is twice that of another. Firstly, in the United States there is without doubt a greater added value through the use of new technology. This means that the country’s level of production has more robust prospects for future growth. The other reason is much more basic. It’s a question of workers perhaps with greater efficiency and therefore greater output. I believe that the first

reason is more strategic, and the second more contingent. The liberalisation of the labour market could already bring us much closer to American levels of productivity without of course harming workers' rights in any way or losing harmony with the global economy. The second reason is much more structural, and depends on the country's cultural level and what it has been able to do through incentives to universities, added value through research financing, and encouragement of technological development.

Erhard Busek: Thank you very much. Peter Mandelson, you are next.

Peter Mandelson: Do you want me to address all the questions or just the last one that was focused on me? Let me just say in response to the earlier questions about America and the dynamism of Europe's economy that for all the unattractive features and problems of corporate governance in the United States, the fact is that American product markets work better and more efficiently. Its labour markets work better and more efficiently, its capital markets work better and more efficiently; is it therefore surprising that it's easier to start businesses in America? It is also easier to see your business fail in America and not to be stigmatised for the failure, so that you can then start again with a different idea. They have a powerfully driven science base, the best in the world. Investment is required in research and development which can then be converted into profitable activity.

It is that liberalisation, that flexibility, that investment in research and development and in a science base that we need more of and should move more towards. Yet we should retain the other attributes that Europe has and America doesn't have. Is the government going to win a referendum on the single currency should one take place in the foreseeable future? Well, as I said in my remarks, if we rely on a hard-headed economic test of the economic facts, if we have a proper economic assessment and do not fudge those tests or shorten them in any way at all, then I believe that that will carry immense conviction when the Chancellor of the Exchequer makes his decision.

For all his reputation for hardness, prudence, and skill in managing the British economy over the last five years, if the Chancellor were to get up and say to the British people I have looked at the tests, I have made my assessment, and I think it's right, not only in principle, to go for the single currency, I think you will see the impact. The debate that follows will have a considerable influence on the British public. The opinion polls that are taking place now are completely meaningless. They're worse than meaningless. They distort the picture because that assessment and that debate have not taken place yet. Neither the Chancellor, nor the Prime Minister, nor the government have put their weight behind a recommendation for the single currency. I am confident that in event of them doing so, the impact will be such that the result would be a yes vote.

I'm very sorry, I didn't understand the second part of your question about kingdoms and republics, but anyway, I think I've probably said enough as it is. I will take that up later.

Erhard Busek: Thank you very much. I think we have now reached the end of this second session of this morning. Many thanks to the panellists.

We have tried to touch on several subjects of interest to the business community within a comparatively short time. We started with EU enlargement and we came to understand what an opportunity the enlargement of the European Union is. It is certainly an opportunity for the economy and for business, but I think it is a real opportunity also politically. We have to congratulate ourselves that it is possible now for enlargement to take place. Things were very different ten or fifteen years ago. Nobody expected that in 2002 we would be able not only to speak about the current enlargement, but also about the perspectives of a wider Europe. It is quite an achievement.

I believe we must acknowledge that enlargement opens a new perspective for the 21st century. The concept of peace, which is the real background of European integration, is truly working. As Coordinator of the Stability Pact for South East Europe, I also want to mention that part of Europe. I am asking you for empathy, as these countries have a great deal to overcome, not only the years of communist government, but also the fact that we have a completely new and different map. In the immediate neighbourhood of Austria and Germany, fourteen new states were created! In case one of you owns a printing company producing maps, it is a good business, but to deal with this on an everyday basis is quite another matter!

In South East Europe, enlargement and European integration are the only viable options for stability. They have to overcome a long history. As Winston Churchill said concerning the Balkans, "They have more history than they can consume." I see that they are trying to do a great deal and I think this has been accepted on our side. That's what I mean when calling for empathy. The future of our continent will see fewer borders, not only between states, but also concerning currencies. We shall take on more and more common responsibilities. It is said that the word Europe comes from the Assyrian word, *erip*, meaning dark, where the sun goes down. Our feeling for Europe is that the sun is coming up. For this, we can congratulate each other. Now I shall hand over to Mr Simonelli. Thank you.

The challenge of the enlargement of the European Union for the cohesion policy and the economic perspectives

by

Robert Leonardi

1. Introduction

After 2004 the European Union (EU) will have the opportunity to spread to a dimension of half billion people and to reassemble, on an adherence basis, the historical unit of the European continent. The foreseen enlargement towards East and South transforms the Union from the assembly of numerous to the assembly of almost all European countries. The difference is not qualitative but substantial. It is really realising the vision of a single European market and of an European political organism, whose borders reach Russia and Ukraine, containing it. The enlargement implies not only the perspective of an economically stronger but also ideally more united EU after the half century experience of separation and conflict imposed by the logic of the “cold war”. The enlargement favours also the perspective to

increase the relationships between Europe and Russia on one side and the Mediterranean countries on the other.

The enlargement is not an Utopia, and the realisation of its potentialities implies to positively face many economic, political and institutional challenges. A long round of meetings of the European Council, starting in Copenhagen in 1993 and ending in Laeken in 2001, identified the candidate countries and outlined the conditions for their entry in the EU. For the first time in the history of the EU, the number of the candidate countries is ten, thus making this one the widest enlargement. For the first time, it has been considered the entry of countries with great development delays, thus making this one the most complex enlargement. For the first time, the enlargement takes place after that the EU realised the single currency, thus making this one the most differentiated enlargement. As usual, the Commission has the responsibility to monitor the acquisition of the *acquis communautaire* by the candidate countries and to inform the Council and the Parliament that it has taken place. Formally, the *acquis* comprises all institutional and legal reforms to be adopted so that the standards and procedures regulating the decision-making and policy implementing conduct within a candidate country can be in line with the standards shared by the Member States. There is also

a financial and economic acquis regulating the status of public finance and of the economy aiming at the accession. The candidate countries are evaluated to verify their ability to be part of a market competitive system and, if necessary, to qualify for the participation to the European Monetary Union.

This report outlines the perspectives the various candidate countries have, to satisfy the EU membership criteria as far as concerns the implementation of the cohesion policy, i.e. the existence in the candidate country, of institutions and standards enabling it to take part to the multi-level and multi-subject governance of the cohesion policy and other Community's policies. This type of analysis, carried out for each candidate country, must necessarily include the profile of the country's economy and of the tendencies characterising it in the last decade. But the qualifying point is the evaluation of the national administration's ability to manage the resources for development and to cope with social subjects and with institutions at intermediate and local levels to actuate the programmes negotiated with the Commission.

The governance ability is the aspect requiring more attention by the Commission in the negotiations with the single candidate countries¹, as it is considered the most important aspect after the studies carried out on previous enlargement phases, but also learning by the experience done in the weakest regions of the European Union (the regions of Objective 1). For instance, in their analysis of the evaluations of the work done in the regions of objective 1, Hurst, Thisse and Vanhoudt² note that the ex-post evaluation studies of the programmes of Objective 1 emphasized the correlation between low growth levels and administration efficiency:

The quality of the regional government is the critical element if the development programmes must be sufficiently made ad hoc for local conditions. As a lot of information is needed to formulate a good

¹ The negotiation between the Commission and the candidate countries is done on an individual basis. Each country must satisfy the conditions for the access, and the final decision, once that it has been taken, is applied to one state even if the negotiation is performed at the same time with all candidate countries. The negotiations with Cyprus, Estonia, Poland, the Czech Republic, Slovenia, and Hungary started in 1998 while those with Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia started in 2000.

² See the article on European 'regions in crisis' made by the authors for the European Bank for Investments: Christopher Hurst, Jacques-Francois Thisse, and Patrick Vanhoudt, "What diagnosis for Europe's ailing regions", *EIB Papers*, Vol. 5, No. 1, 2000, pp. 9-22.

policy, mistakes are expected to be done with a certain frequency. However, it seems that mistakes occur with a frequency beyond comparison from the administration of some of the regions (p.27).

The Commission came to the conclusion that the candidate countries, to prepare to enter the Community, must count upon their ability to economically meet the levels of the EU's Member States, but they must also try to align their institutional structure with the European one and to adopt the European procedural standards.

2. The previous enlargement experiences in the EU

The Union is not new to enlargement processes. On the contrary, it grew up incrementally since the first six Member States created the European Economic Community with the Treaty of Rome (1957). Four enlargement phases underlined its growth up to now, and the access of the group of ten candidate countries represents the fifth enlargement phase. In the various enlargement phases, it was gained a great patrimony of experience that is important to consider in this pre-accession phase, which prepares and supports the entry. The first enlargement took place in 1974 when Denmark, Ireland and

United Kingdom became Members of the European Economic Community. Then came the accession of Greece in 1981. In 1986 both Iberian countries, Spain and Portugal, joined and in 1996 there was the accession of three new countries, Austria, Finland and Sweden, while Norway renounced the accession for the second time.

A first consideration to be done is that the four enlargement phases showed that the process to become a Member of the Union resulted to be less dramatic for the candidate countries than many had foreseen. It is clear today that this is partly due to the fact that during the negotiations, that in all enlargement phases have always been very long, the candidate countries could start reforming their institutional structure and their set of rules to qualify for accession. The negotiations for enlargement have always been an opportunity for a preventive adjustment and an incremental adaptation, in the sense that after the accession, no one of the new countries experienced an institutional or economic 'big bang' as the alignment correctives had substantially already been set up. This happened in case of countries with a delayed development in comparison with the Member States' average, as it happened for the first case of Ireland and later for other so called peripheral countries, as well as in case of prosperous countries contributing to the community balance as happened for Finland.

A second consideration concerns the rapidity of adjustment of the candidate countries, once they became new Member States, to conform with the European political and institutional framework.

This is new for them and centres on the complex relationships between the Council of Ministers, the European Commission and the European Parliament. For the Member States it means an immediate confrontation with the partial loss of national sovereignty and the consequently acting as co-participant of a complex decisional process. It means also the interest to realise, as full title members and starting right away, the participating opportunities to the decisions of a political and economic entity with a global dimension like the EU.

A third consideration concerns the civil society and the organized socio-economic forces of these countries, which tend to see with great sharpness the completely new role opportunities for themselves. The entry in the EU attracts everywhere many of the private entrepreneurs, mostly medium and great, but also small ones like for instance in Greece, and trade unions and environmentalist associations like for instance in Ireland. The forces of civil society promoted the entry of their countries, but also pushed them to promptly adopt the necessary reforms. The availability of resources for the development through the cohesion policy and the access to the resources of the agricultural policy have been two strong inducements to stimulate the support to the entry from organized forces of the civil society.

After these basic considerations on the past enlargement experiences of the EU, we are now interested in deepening the investigation of institutional and economic conditions, which accompany,

and accelerate, the process of adaptation to the condition of Member State. All ten future Member States have regions qualifying for the status of Objective 1. It is therefore important to understand what relationship exists between an effective intervention programme for the development and an institutional structure permitting this country to maximise the governance benefits of the actuation of the same programme.

In comparative terms, it is not easy to separate the impact of the structural features of the regional economies (for instance, the condition of the infrastructures or the workforce competencies) on the result of economic growth from the impact of the political and administrative traditions of the regions being under examination (for instance, the presence of parties in the territory or the administrative hierarchy) on the same growth result. Looking at the Member States we can see that the differentiation of political and administrative traditions is marked. We can identify a group of countries with a similar basic institutional feature, those having regionalized or federal systems like Germany, Austria, Belgium, Spain, Italy and France. Other countries introduced forms of partial devolution like did the United Kingdom for Scotland and Wales. Portugal created regional governments for Madeira and the Azores a long ago, but it did not do the same for the rest of the country. In 1986, Greece instituted regional districts that are directed by prefects appointed by the state, but it did not succeed in

creating representative institutions at this level. Ireland, Sweden and Finland experimented ad hoc regional structures, but they did not institutionalize them.

Even within the first grouping of countries the institutional differences are very big. Although all these countries created sub-national governments, the decisional functions assigned to them varies greatly. The French regions have much more limited powers for managing the resources in comparison with Spanish and Italian regions. In the United Kingdom, Scotland has more powers as far as concerns the territory programming and development than the Wales. In Germany, although the Länder have the same political status, there is a huge difference of economic power between Länder of the east part and Länder of the west part of the country.

In the light of the great heterogeneity of structure and powers of the sub-national institutional systems between countries, it is easier to study the connection between different levels of economic efficiency and institutional efficiency within the borders of a country. But the existence of a common European cohesion policy requires the understanding of the basic conditions making more achievable a result of cohesion in the European dimension.

For those candidate countries having regions that after the enlargement will be in Objective 1, there will be later shown the analytical considerations based either on official documents and reports or on inferences deriving from the experiences of the Member States. The eight candidate countries of

Central and Eastern Europe —the so called CEEC countries—together with the little Malta and the Greek zone of Cyprus must face, at the same time, the problem of the development taking part to the cohesion and to the institutional restructure policy to get the participation tools³. At the same time, in the negotiations, they are asked to use their participation in the cohesion policy to promote the basic democracy and include the civil society in the interventions for development.

Taking lessons from the experience of actual Member States in managing the cohesion policy we must resist the temptation to think to a solution that fits all countries, from the big ones to the small ones, and from those that in the transition from planned economies to market economies have already experienced respectable growth level to those that did not yet succeed in starting the development. Christian Weise and his collaborators, in their recent study about the ten CEEC countries, including the eight candidate ones, and about their regional problems, drew conclusions, from the three programming cycles of the Structural Funds, highlighting that the critical element is the institutional

³ The rules defined by the 1260/1999 Council's Set of Rules about the administrative framework for the management of Funds and the 448/2001 Set of Rules on the financial control are not an option, but make part of the administrative structure that all countries receiving Funds must observe. About the concept of 'good governance' please refer to the Ministry of the Treasury, "Systems for management and control of interventions co-financed by Community structural funds for the period 2000-2006 according to the Art. 38 of the Reg. EC 1260/99," March 2001 and the Commission's White Book (2000) about governance.

ability which requires a long term learning period. Starting from this conclusion for the CEEC countries, they propose a primary role for the national level:

“Given the institutional heritage in many CEEC countries, and considered the absence of government on a regional level and the slowness of the territorial administrative reform process, it is important to recognize for the moment the primary role of the national government in the actuation of the expenses of the Fund and to respect the institutional differences among different countries ”⁴ (p.136)

The fact that there is an inevitable learning curve in the use of the Funds is a result consolidated also by the examination of the cases of the Italian regions. The conclusion that the CEEC countries will not be an exception to the rule is convincing. The examination of the Italian regional cases suggests that the length of the learning period depends on two playing elements, which vary inside Italy as it is a country with a strongly regionalized structure. Examining the CEEC countries, the factors are the different technical and administrative ability of each of them to adopt the rules and procedures governing the EU cohesion policy and the different political will to perform the necessary

⁴ Christian Weise et al., The Impact of Enlargement on Cohesion, German Institute for Economic Research and European Policies Research Centre, March 2001.

institutional reforms in order to connect the centre and the periphery of the institutions of the country. The Commission seems to play its part. During the negotiations with candidate countries it continued insisting on the point that all countries must adopt the *acquis*, which requires the creation of sub-national institutions taking part in the governance of the cohesion policy.

With the conclusion of the European Council of Laeken of December 2001 and the Commission's note of the 30th of January 2002 on "Common Financial Framework for the Accession Negotiations"⁵ the number of countries which will become members of the EU has been officially reduced from the twelve considered by the Agenda 2000 and by the Second Report on Cohesion⁶ to the actual ten. Romania and Bulgaria did not open the negotiations on a series of policies interested by the Community's *acquis* yet and both their economic conditions and the status of public finance indicate that these two countries need more time to adequate to the accession's requirements. This is the case of the contents of Chapter 21 of the *acquis* concerning the negotiations about the actuation of the cohesion policy and the creation of sub-national levels of government with decentralized powers. For either

⁵ See: Commission of the European Communities, Information Note on Common Financial Framework 2004-2006 for the Accession Negotiations, Brussels, 30.1.02, SEC(2002) 102.

⁶ European Commission, Unity, solidarity, diversity for Europe, its people and its territory: Second report on Economic and Social Cohesion, (Luxembourg: Commission of the European Community, 2001).

country there will be no negotiation on this chapter in the near future, but an initiative from them is awaited.

Until the end of this year the challenge of the enlargement bases on the ability of the ten candidate countries to complete the negotiations with the Commission and to use next year, 2003, to ratify the agreement. The ratification implies initiatives in each candidate country, such as referenda and/or Parliament's acts as well as the approval of the accession agreement by the Council of Ministers and the European Parliament. This background opens the way to the ten candidate countries to become full title members of the EU at the beginning of 2004⁷.

3. The economical contest of candidate countries and the cohesion policy

As it has been previously pointed out, the determination of the economic conditions characterising each candidate country is one of the key points of the accession negotiation. It is not only a matter of collecting statistic information, but of arriving to evaluate the measures of economic modernisation

⁷ The candidacy of Turkey is not valid at the moment because the country did not meet the pre-conditions for the beginning of negotiations, as far as concerns the question of respect of human rights and guarantees for political and civil rights.

implemented in each country in the context that produced them and, even better, of evaluating the perspectives of growth after the accession to the EU. It is therefore necessary to deepen into the details of the negotiations in process between the Commission and the Candidate Countries for the acquis in general and for Chapter 21 in particular. The Objective is to examine the possible impact of the enlargement on the institutional and economical equilibrium of the Union and to consider which will be the perspectives for a further enlargement after 2004 and after the accession of the new ten Member States.

The examination of the economical context of eight of the ten countries, the so called PCEE, is particularly interesting because in the last decade they started a radical transformation of their economic system. Each of them went from a personal version of the soviet model of centre-directed economy to a personal version of market economy. All eight countries aim to place in such a way to be able to compete on a European and world-wide level. This transition implied a significant restructure of the production activities in the industry, agriculture and services that saw a wide privatization of public firms, especially of the great firms of the basic services and those to which a monopoly had been granted. Besides, the transition from the previous economic system encouraged these countries to redirect their commercial exchanges, loosening them from the tight borders of the import-export within

the block of eastern countries they belonged to. They now look for relationships with the countries of the rest of Europe and of the world.

Observing the localisation of the eight candidate countries from the point of view of the infrastructures and of their relatively easy access to the markets of the Member States, we already note important differences. Five out of the eight (Slovenia, Hungary, the Czech Republic, Slovakia, and Poland) countries border directly with Member States (Germany, Austria and Italy) and already enjoy the best position because they lie on the path of one of the multimodal transport 'corridors' which will connect them in short times to important production and market centres in the EU. The other three (Estonia, Lithuania and Latvia) do not border directly with Member States, but lie on the eastern coast of the Baltic Sea. They foresee therefore, in medium times, a more efficient and intense use of that sea way of connection between them, Finland and Sweden. The result of the simultaneous accession of Poland and Lithuania to the EU is a region of the Russian territory (Kalingrad) completely surrounded by EU's Member States⁸.

⁸ It implies a problem of road and railways connections between the EU's Member States that has to be solved. The problem has already been examined by the Conference on Transports of Helsinki of June 1977 and by the Commission in its Transport Infrastructure Needs Assessment (TINA) Report of October 1999. After the completion of the enlargement it will be given a particular attention to the position of Kaliningrad. See The Russia

The other two candidate countries, Malta and the Greek zone of Cyprus, are the two little insular states in the Mediterranean Sea, that already have close relationships with the countries of the Union. Both have been British Colonies and both have experienced strong political turbulence from the date of independence, trying to define their internal political position and their international position in the Mediterranean Sea. In the nineties, Malta and the Greek zone of Cyprus have had fast rates of economical growth, similar to those of the three meridional countries of the Cohesion Fund (Portugal, Spain and Greece). Therefore, their actual situation is that they need less support for the development in comparison with the other eight countries.⁹

The decision to exclude both Romania and Bulgaria from the next EU enlargement phase, dated 2004, facilitated the consent for the new enlargement. The economic conditions of the eight candidate countries are namely much more solid than that of the two countries whose active candidature is

Journal, 1st May 2002 for the declarations of the Russian Prime Minister, Mikhail Kasyanov, about the request from Kaliningrad of full and free access to Russia. www.russiajournal.ru/news/index.shtml?nd+12910.

⁹ The exception would be the case of the northern zone of Cyprus, which is occupied by Turkey since 1974 and has a strong delay in development. According to the most reliable opinions, as statistical data to verify the condition of underdevelopment are lacking, the per capita PIL in the zone with a majority of Turkish populations is certainly among the lowest of the EU's Mediterranean regions. Negotiations between the two parts are in process from the 3rd December 1999, under the auspices of the general secretary of the United Nations, to solve the international-political problem of the occupied zone. If the negotiations will bring to an agreement for the reunion of the island, the Commission will expand the accession negotiations to the whole island.

considered¹⁰ delayed to longer times and of the Turkey whose candidature is inactive. Table 1 shows the first results of the differentiation of the economic situations between the different candidate countries, reconstructing a framework from 1990 through 2000. The data concern the annual growth in the candidate countries. Malta and the Greek zone of Cyprus are in line with the levels and the growth tendencies registered in the three southern countries of the 'cohesion'. The growth averages for the eleven years examined are similar, 5,2% and 3,8% for Malta and the Greek zone of Cyprus and 2,2%, 3,0% and 2,8% for Greece, Portugal and Spain respectively.

On the contrary the PCEE countries experimented negative growth rates in the years between 1989 and 1994 when the most radical structural adjustment in their economy took place, with averages for the first period of five years of, for example, -12% for Latvia and of, for example, -10,3% and of -8,2% for Lithuania and Estonia. From the second half of the nineties, five out of the eight countries (Poland, Hungary, Slovenia, the Czech Republic and Slovakia) registered growth stages that brought

¹⁰ The negotiations continue between the Commission and Romania and Bulgaria, but they are partial negotiations. As it has been told, on some Chapters they are not started yet, therefore the candidacy of the two countries is actually active for the next expansion turn, but it is delayed to a following enlargement phase.

them to the pre- 1989 situation.¹¹ The three Baltic states are in a much lower position in the growth stages as they have slowed their transition process. They show averages for that period going from – 3,4% for Latvia at –2,3% and of –1,6% for Lithuania and Estonia. The two candidate countries for the future, Romania and Bulgaria, remain around the averages of the Baltic countries with a –2,0% and – 2,3% for the whole period. If the growth pace of the last nineties continue until 2003, five of the CEEC countries will obtain an almost complete redirection of its own economy and create the basis for a further growth¹².

Table 2 shows the situation of the candidate countries from the point of view of the inflation rate for the same period, 1990-2000. A first consideration is that the rates of the ten candidate countries have been strongly lowered, in almost all cases, to levels under the 10% in 2000. This result has been achieved starting from the early nineties from very high inflation rates with three-digits. The tendency to improvement has been seen around the half of the decade, until the last more positive results. In 2000 Poland, Slovakia, and Hungary presented still too high inflation stage with two-digits. The

¹¹ In 1998 Latvia was still at the 57% of its economical basis of 1989 while Estonia and Lithuania were at the 76% and 75%. Also Bulgaria and Romania were at the level of two thirds of their economical basis of 1989 (World Bank, World Development Indicators 2000), mentioned by Weise et al., p. 33.

¹² In the last six years the growth of the CEEC countries has been higher than the one registered in the fifteen Member States. See: Jarko Pasanen, "The GDP of the Candidate Countries" in Eurostat, Statistics in Focus, 42/2001.

improvement of the inflation rates reflects the economic recovery in these countries, even if the levels are such to exclude them from the Single Currency system.¹³

The jobless rates in the candidate countries, with the exception of Malta and the Greek zone of Cyprus, show peculiar characteristics that are much different from those of the Member States, both for the levels and for the trend during the nineties (Table 3). At the end of the period, the unemployment levels in the eight CEEC countries are generally high, almost always with two digits. In 2000 the Slovakia registered the level of 19%, but high levels were also those of Lithuania and Poland with a 16% and of the other two Baltic countries, Latvia and Estonia, with a 15% and 14% respectively. Always in five of the CEEC countries, the trend during the nineties has been to a great increase of the jobless rates, while on the contrary there have been registered increases in the growth rates. This suggests that there's a problem of correct data interpretation and reliability.¹⁴ Hungary, Slovenia and the Czech

¹³ The empirical criteria for the adhesion to the Single Currency were: 3% for the deficit of balance and an inflation average a little over that of the three more "virtuous" EU countries.

¹⁴ Since 1996 Eurostat has been collecting data, while the source for the previous years is different. It is the World Bank which uses different definitions and methods of collecting data. There is also to consider the aspect of the structural change of these economies that seem to underlie the same contradiction already seen in the case of Spain during the eighties, when to growth increases corresponded increases of the officially registered unemployment. The question of the measurement of the hidden economy arises. For the CEEC countries it is also to be noted that there have been considerable migration flows in that period, that could be not included in the statistics.

Republic have instead jobless rates in line with those of the Member States.¹⁵ Malta and the Greek zone of Cyprus have very low jobless rates.

Given their relatively low income rates and the absence of particular product specialisation, the CEEC countries contribute only in a small extent to the imports from EU countries and to the exports of their products to the EU (Table 4a). In 1998 the eight CEEC countries took part with a 5% of the total amount of EU exports and with a 4% of imports. The three Member States that have had more active exchanges with candidate countries are Germany, that registered alone the 42% and the 47% of EU exports and imports respectively, followed at a certain distance by Italy (13,1% and 11,5%) and Austria (8,1% and 8,6%).¹⁶

The EU represents instead the main source for imports from CEEC countries and the first market for their exports. Always from table 4 we can see that in 1998 the import percentage were above 50%. In the cases of the three most developed countries, Hungary, the Czech Republic and Poland, both for the import as well as for the export from and to the EU, there have been percentages over the 60%. The greatest part of the import-export concerns machinery and electrical household appliances, electrical

¹⁵ Spain is the only case with a two-digits rate.

¹⁶ Eurostat, Comext.

material and components, and vehicles. This highlights the spread of the European car industry in the areas of Middle Europe and the increase of the consumer goods request in the candidate countries.

The data about foreign investments in Table 4b show a very strong differentiation from one country and another. The indicator of the total amount of foreign investments indicates that from 1989 to 2000 Estonia, Poland, the Czech Republic and Hungary took the lion's share with, 20931, 31508, 23503 and 21063 millions Euro respectively, which represented the 74% of the total general amount. In terms of incidence of foreign investments per capita the Czech Republic, Hungary and Estonia are the three CEEC countries with the highest amount, i.e. with 2.280, 2.099 and 1.450 Euro respectively. At the same time Malta with 5.978 and Cyprus with 2.303 € are the countries with the highest investment levels per capita. If we look at the indicator of foreign investments coming from the European Union, we see that Estonia and the Czech Republic have the strongest presence with percentages of 85 and 83% respectively, followed by Lithuania with 72% and by Hungary and Poland with the 64%. Considering the indicators of foreign investments altogether, the Czech Republic, Hungary and Poland, in this order, are those who have more profited by it. Great part of these capitals are German, French and English. Sweden has been instead the main investor in the three Baltic countries where in 1998 the

Sweden capitals represented the 99,7% of the EU investments in Lithuania, 97,6% in Estonia and 60,9% in Latvia¹⁷.

The last information about the economical context of the candidate countries is given by Table 5 where data are shown, very incomplete though, about the status of public finance in these countries . The period is the quinquennium 1996-2000. The comment for the balance deficit and for the public debt can not be done for Latvia and Lithuania as data are lacking. The data of Estonia balance deficit are available, indicating a low deficit level in 2000. The deficit of the other CEEC countries is pretty low but tends to grow and its levels do not qualify the countries for participation in the Single Currency whose top was established in Maastricht at 3%. The financial situation of the PCEE countries is much better in terms of public debt whose levels are under the maximum of 60% established by the Treaty¹⁸. Both the Greek zone of Cyprus and Malta have more worrying financial data, above all in terms of deficit of balance.

The economic framework that resulted highlights that four of the PCEE countries (Poland, Hungary, the Czech Republic and Slovakia), in the last decade, highly integrated their own economies

¹⁷ Eurostat, *European Union Direct Investment Yearbook*, 1999.

¹⁸ It is necessary to spent a comment reminding to prudence at the light of the scarcity of data concerning the two Baltic countries of Latvia and Lithuania, as well as Romania and Bulgaria.

with those of EU Member States and that they will not encounter particular problems after their full integration in the Single Market after the enlargement. The data concerning Romania and Bulgaria on the contrary are not in line with the other candidate countries. The import-export with the rest of Europe is still low, inflation is not under control yet, and the status of public finance is uncontrollable.

Some questions left open also about the Baltic countries. Their economical basis remain weak and must strengthen before their PIL reach the pre-1989 levels and the state of their public finances is at least questionable. Their very tight political and economical interaction with the Scandinavian countries, particularly with Sweden, plays in their favour, and helped them in the membership application.

A last remark is about Slovenia, which represents a little surprise as it did not show a particular growing trend despite its position advantages bordering with the north-eastern Italian area, which is one of the most prosperous and economically lively areas of Europe¹⁹, and is crossed by the "V corridor" for multimodal transport. Foreign investments have been very restrained, the PIL percentages are at the level of Bulgaria. Slovenia had a good status of public finance, namely the best

¹⁹ For an analysis of the slowing factors of the Slovenian growth see Miroslav Glas, Phare CBC Slovenia-Italy. Cross Border SME Strategy, SEED BIC, Friuli-Venezia Giulia, 2001.

one, and important tourist and natural resources for a small country. Slovenia is in such a position that it can get the maximum benefit from the increase of import-export with the rest of Europe.

4. The institutional contest of candidate countries and the cohesion policy.

In the accession negotiations the commission's attention is now focused on the ability of candidate countries to acquire the *acquis communautaire* in the whole, in other words as far as concerns all 'chapters' of legal and administrative sectors. Table 6 sums up the state of negotiations on Chapters in October 2001.

When examining the steps carried out by the various candidate countries, it is necessary to consider that four of them—Latvia, Lithuania, Malta and Slovakia—began the accession negotiations with the Commission later than the others. The first six countries, namely, opened the negotiations under the Finnish Presidency in 1999, while the other four began the formal negotiation in 2000. The institutional framework for the accession negotiations with the candidate countries has been

established at the European Council in Nice in December 2000 and the debate about the institutional reform of the EU has been separated from the negotiations on the enlargement²⁰.

Although considerable steps forward have been made in a certain range of sectors, less could be done regarding Chapter 21, which concerns the actuation of the cohesion policy by means of development programmes. This difference is partly due to the fact that the positive conclusion of negotiations on Chapter 21 requires the ability to move along two axes. The 'horizontal' axis concerns the mechanisms for the actuation of programmes and investments on a national level, between Ministries and administrative agencies taking part to the formulation and actuation of the cohesion policy. The 'vertical' axis concerns the connections between centre and periphery, that is to say the relationship between national and sub-national institutions. In all cases the candidate countries do not have a tradition of self-governing sub-national political and administrative institutions. In the communist form of government the centralisation of the decisional functions was the standard and a decentralized alternative, especially at the intermediate level, was inconceivable. A similar tradition

²⁰ The separation of the enlargement from institutional reform within the EU was necessary to avoid being in a 'double decisional trap' where the enlargement perspective become hostage of the lack of agreement about the institutional reform.

was found in the three Mediterranean countries –Portugal, Spain and Greece—until the fall of the old fascist governments in the seventies.

The evaluation made by the Commission in October 2001, concerning the progress made by candidate countries in acquiring the *acquis* was that five of them are able to complete their institutional structure in the time remaining for the negotiations. They are the Greek zone of Cyprus, the Czech Republic, Estonia, Hungary, and Poland whose institutions will be effective by the accession date, 2004. This first group of countries has already national institutions functioning and started to create the intermediate level and to prepare it for socio-economic programming duties, as well as to approve measures for the entry of local groups and institutions.

The other five countries—Latvia, Lithuania, Slovakia, Slovenia and Malta—have still a lot of land to cover before arriving to get the *acquis communautaire* in its generality. In Latvia, Lithuania and Slovakia there have been a confused definition about the responsibilities for programming and management of Funds. This problem arises in the horizontal interaction between ministries that will take part to the cohesion policy, but also in the vertical connections between Ministries and sub-national levels.

At the end of 2001 the Latvia proposed to consider the whole country a NUTS II region, which requires only the preparation of the Single Document for Programming instead of a QCS for the

cohesion programme. The Latvia proposed that the administration of the DOCUP were done by the Ministry of Finance and five regions with a NUTS III programming level, but it is not clear who will work for these regions nor who will have the supervision function of the programme implementation. In Lithuania, the first draft of the National Development Plane for 2001-2003, which must support the investment programme financed by the EU, according to the Commission's report is lacking because of "a series of structural weaknesses like an insufficient inter-ministry co-ordination and the participation of local, regional, economical and social partners. The Plane for National Development lacks also an institutional and financial frame, which would permit the actuation of the priorities and of the measures indicated in the preliminary draft."²¹

The Commission appeared very worried for the doubtful preparation of the administrative staff and for the procedures of financial management concerning the investments of the European Social Fund in Slovakia. The actual audit procedures and the availability of qualified personnel to monitor and evaluate programmes are considered less than acceptable. The Slovenia, for its part, has

²¹ See the negotiations' deliberations of Chapter 21 in 2001 Report on Lithuania in <http://europa.eu.int/comm/enlargement/lithuania/index.htm>, p. 81.

been less than open for the decisions to change the administrative structure for the management of Funds. It has still to decide which organisation give to the sub-national levels for programming and realising.

In bigger Member States the Commission emphasized the need to reorganize the national institutions and the staff, but also not to loose sight of the importance of the role of the institutions at a local level. In the negotiations with the Czech Republic it has been soon achieved an agreement concerning the new territorial classification of 'regions of the cohesion' which consists in fourteen NUTS III areas and eight NUTS II regions. For statistical reasons the new classification became effective in January 2000. An year later the legislative framework, which includes the new classification for the purposes of planning and actuating of programmes, has been adopted.

Also Hungary made quick progresses in defining its regional statistical units and the organisation structure. The structure has been already approved in 1997, and since then statistical data have been collected on that base. In latest years Hungary cleared the structure for Funds' managing and started the training of personnel. In 2001 it began preparing a National Plan for Development according to the procedures shown by the Funds' Set of Rules. Soon after, a committee between ministries was created to co-ordinate the national Plan and one of its sub-committees had the responsibility to organize the Task Force for the National Plan. The Task Force is made of five working

groups dealing with regional, economic, agricultural and rural development, infrastructure and development of human resources. In Hungary there were also made steps forward in satisfying the criteria of the partnership principle, institutionalizing the participation of interest groups and of the Presidents of the Councils for the regional development in the National Council for the Regional Development, that is consulted in the preparation of the National Development Plan.

Poland moved not so well in comparison with the Czech Republic and Hungary to create the regions of NUTS II. At the end of 2001 the NUTS III units had already been made or were about to, but it was not done a lot to prepare an acceptable proposal able to design the regions of NUTS II. On a national level the responsibility of the Funds' administration continued to be moved from a Ministry to another.

To remedy, at least in part, the problem of limited times the candidate countries will have when setting up the development programmes after the enlargement, i.e. from 2004 through 2006, the Commission recommended that the countries submit a Single Planning Document²² at the time to undersign the Accession Treaty. This document should intervene only on some priority infrastructure sectors. For candidate countries, the period 2004-2006 will be a preliminary exercise in learning how to

²² The DOCUP includes both the general development programme and the working programmes for the different sectors.

actuate the development policy while the main test is postponed to the next fourth cycle of the cohesion policy formulation.

5. Candidate countries and pre-adhesion programmes.

Once that the institutional structures for management of the cohesion policy by means of the development programmes exist and are effective, it remains open the question if the ten countries will be able to spend effectively the resources assigned to them, to co-ordinate national and local policies and to evaluate the policy's priorities and the procedures' actuation priorities. Negotiations do not give any precise information about the real ability of the new Member States to programme, handle and spend resources. In the negotiations was emphasized the ability of candidate countries to satisfy the formal legislative and procedural requests, as indicated by the Commission. In the past also the EU programmes, like the PHARE programme, paid more attention to the formation of personnel and to the reorganisation of the administrative systems than to practically experiment the management of programmes.

The PHARE Programme began in 1989 to help Poland and Hungary to restructure their economies and institutional systems²³ and it was later extended to the other CEEC countries in 1994. Since then it represents the most important instrument for technical and financial assistance extended from the EU to the CEEC candidate countries. In 1998 the PHARE Programme was extended also to the Greek zone of Cyprus and to Malta. In 1994 a new component, i.e. the cross-border (PHARE-CBC), was added to the programme, to promote the co-operation between the candidate countries having borders in common with Member States and the Member States themselves.

Within each candidate country the PHARE Programme has been treated almost exclusively like a programme with a national character, paying low attention and directing scarce resources to the sub-national level. Until today there have not been evaluations of the PHARE Programme to determine how it has been received in the various countries and which impact it had on structures and administrative behaviour.

Moreover, information is lacking about the use of the resources that the EU assigned to candidate countries for the period 2000-2003. These are the Funds for the pre-accession that are

²³ The official name of PHARE was “Poland and Hungary: Action to Restructure the Economy ”

managed by the new ISPA²⁴ programme, and that make part of the budget of the third cycle for the actuation of the cohesion policy, 2000-2006. It is also about the new SAPARD²⁵ programme for the rural development, which is financed by the agricultural Fund. It is therefore difficult to foresee which form will the learning curve of the candidate countries have when they access to the Union as a member and fully qualify for the use of the Funds, or to foresee how the structure of connections they will create between their centre and sub-national levels will work.

The evaluation of the ISPA programme made in October 2001 by the Commission, shows the difficulty we meet when referring to current activities to get indications on how the candidate countries will be able in the future to handle a fully articulate cohesion policy. Starting from the assignment of 3,12 billions Euro in 2000, in that first year the ISPA management committee accepted seventy five projects for a total amount of only 997 millions Euro, less than a third of the available resources. The average cost of projects financed by ISPA is of 13 millions Euro, the 64% of which is financed by ISPA,

²⁴ The acronym ISPA means Instrument for Structural Policies for Pre-Accession. It was created in 1999 with the 1267/1999 Regulations to finance infrastructure and environmental projects in the CEEC candidate countries. The programme does not apply to Malta and to the Greek zone of Cyprus. In 2000 the budget of ISPA was agreed on 3,12 billions Euro per year for six years.

²⁵ The acronym SAPARD means Special Accession Programme for Agriculture and Rural Development. The programme helps candidate countries to reorganize their own agricultural sector in preparing their entry into the Common Agricultural Policy.

even if the percentage could reach the 85%. Many projects have been able to obtain co-financing from the European Bank of Investments, from the European Bank for Regional Development, from international financial institutions and from foreign givers.

The mixed form of project financing facilitated, in the candidate countries, the support for the acceptance of the *acquis communautaire* for the preparation of projects, the procedures to contract and contracts, when it was clear that other international institutions, beside the EU, asked for a similar level of technical competence and administrative clearness. Candidate countries had more difficulties accepting the request to prepare evaluations with environmental impact before obtaining the project financing. Besides, each candidate country had to formulate a strategy for the ISPA investments, although it is not a complex document like DOCUP and QCS. The ISPA programme is namely a programme of self-standing projects that do not make part of an integrated development programme. The same is valid also for the SAPARD intervention.

At this point it is not possible to insist on the fact that the candidate countries have to clearly show their ability to handle the future cohesion policy as they become Member States. As it previously happened with the actual Member States, we hope that the future new Member States will be able to incrementally correct their decisional processes and incrementally improve their structures should it turn out clearly that they are both inadequate. CEEC countries made a certain experience with the Pre-

Accession programmes, besides the fact that the moment of their entry in the Union will arrive after fifteen years of economical and political transformations. The effective use of the EU resources aiming at the cohesion, is fundamentally a 'learning doing' process. The essential thing is the political will of the future Member States to learn and adopt the necessary adjustments.

6. New Member States and adhesion balance, 2004-2006

After their full title entry in the Union in 2004, the new Member States will benefit of the Fund resources and of the Agricultural Policy, according to a proposal presented by the Commission on the 30th January 2002 and that is based on the commitment taken in the Summit of Berlin of May 1999. The Summit decision refers to six candidate countries—Greek zone of Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia—and to their entry foreseen for 2002. This objective was missed because of the lack of agreement at the European Council of Nice in December 2000. The commitment to the enlargement has been recovered at the European Council of Laeken in December 2001 when the number of candidate countries has been brought to ten with the addition of Latvia, Lithuania, Slovakia and Malta, and the date of the new phase has been moved to 2004.

As it has been told, the exclusion of Bulgaria, Romania and Turkey facilitated the enlargement agreement that would not have been possible at the light of the restrictions adopted with the agreement of Berlin and concerning the budget. The agreement foresaw the assignment of resources for the accession for the years 2002 and 2003, but did not make possible to transfer these resources to the period 2004-2006 in order to consider a bigger number of candidates if necessary. The balance agreement of Berlin has also put limits both to the expenses duties as well as to payments to move from the theoretical roof of 1,27% of the EU balance to the 1,01% that is the real roof established for payments.

The Commission had to prepare the Accession using the resources assigned for the last three years of the fourth balance cycle, 2000-2006, which was of seven years. The Commission succeeded in remaining within the assigned budget, as shown in Table 7, cutting the expenses of the Agricultural Fund severely. The mechanism is the suspension of the support to the prices for the new Member States and the percentage of 25% of the agricultural budget for the same countries as far as concerns the programme of rural development. There is also the prevision to bring new Member States in line with others for the agricultural expense only in 2013.

The resources for the cohesion policy are assigned more quickly. In this case the proposal is to assign to the new Member States the significant percentage of 75% of what they supposed to receive by

2006. But they will have to operate within the limit of assignment for the Funds that must not exceed the 4% of the PIL of the country. In the past, countries like Ireland and Portugal received EU resources much superior to that level.²⁶

Finally, the Commission underlined the fact that during the adhesion period 2004-2006 the new Member States must continue to give particular attention to the 'internal policies', that in terms of programmes means the demolition of nuclear power plants in Slovakia (Bohunice) and Lithuania (RBMK) and investments in activities like 'institution building' for retraining of personnel and reinforcement of the administrative structures. At the moment, the 'institution building' initiatives are financed with 1 billion Euro per year thanks to the PHARE programme. This financing level must be supported now with the resources of the Funds, to get institutions able to take part to the governance of the cohesion policy.

²⁶ See A. Mairate "The experience of structural policies in Europe: an evaluation in the whole", The institutions of Federalism, March-April 2001, pp.361-392..

7. Conclusions

The analysis contained in this chapter moves from the assumption of the centrality of the enlargement for the political and democratic meaning that the concept of European Union acquired. In this sense, the chapter proposed to analyse the perspectives of the ten candidate countries to conform to the EU membership criteria the as far as concerns the actuation of the cohesion policy. Analysis of the previous enlargement experiences of the EU have been shown. The economical and institutional context of the candidate countries in relation with their participation to the cohesion policy have been examined. Finally, the European Pre-Accession programmes and the budget proposal for the first three years after adhesion of the candidate countries have been discussed.

If the enlargement is important for the EU it is all the same important for the ten countries because the import-export with the EU constitutes the biggest part of their imports and the EU capitals are a considerable majority of foreign investments on their territory. From a political perspective the accession is even more significant. The motto adopted by Hungarian authorities, saying that Accession means a 'return to Europe' after years of conflict and

separation, expresses the relevance of the new enlargement phase foreseen for the 2004. The motto is the same that underlines the Commission's commitment to push in favour of the enlargement and bring it to the finishing straight, despite difficulties and false starts. After the stalemate produced at the Summit of Nice in 2000, the Summit of Laeken in 2001 reaffirmed the commitment of the EU in the enlargement, making it definitive.

For the Prodi Commission the enlargement assumed the appearance of 'raison d'être' or of mission defining its supporting values, like the realization of the single market defined those of the Delors Commission. From the Commission's behaviours and documents we are able to state that there are values of solidarity, but also of efficiency, of vision but also of political realism, of tenacity but also of flexibility.