European Accession and Capacity–Building Priorities

Almost 40% of the trade gains for the new members come from improvements in IT infrastructure

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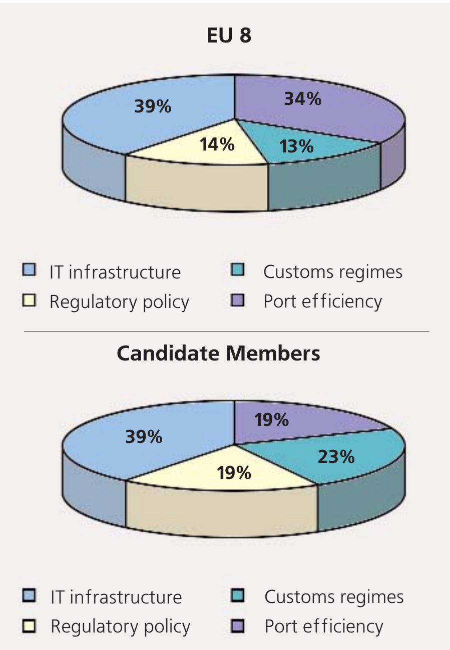
In the transition countries of Europe reducing barriers to trade is increasingly seen as the key policy priority to accelerate integration into the world economy, including through membership in the European Union. A broad definition of "trade facilitation" involves not only improved efficiency in logistics at ports and customs and the use of advanced technology, but also streamlined regulatory policy, deeper harmonization of standards, and conformance to international norms.

EU membership should, over time, facilitate the movement of goods between member states. The harmonization and implementation of the *acquis communautaire* also require new member countries to make major improvements to their overall economic environment both at and behind the border.

In our research paper, we examine the four dimensions of trade facilitation — increased port efficiency, customs regimes, regulatory policy, and information technology infrastructure — in order to estimate the gains from trade to the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia (hereafter EU-8); and Bulgaria, Romania, and Turkey (candidate countries).

Relative Trade Gains due to Improved Trade Facilitation Indicators



Facing Different Challenges

We first measure how far a country's performance is from the best-practice country in each of the four dimensions. The best-practice country is indexed to a value of 1.0.

The 15 EU member countries are relatively advanced in all four areas, with an average value of 0.82, 0.87, 0.79, and 0.78 in port efficiency, customs regimes, regulatory policy, and information technology infrastructure, respectively. The EU8 countries, however, are less developed in these four areas with an average value of 0.60, 0.73, 0.65, and 0.64, respectively. As for Bulgaria, Romania and Turkey, the development of their trade facilitation is further behind, with the state of their customs regimes estimated at just 58% of the EU-15 level.

The level of development of the new and candidate member countries varies most in port efficiency, where Estonia and Latvia are the top performers with 70% of the best EU-15 performers. In regulatory policy, the development levels of all the examined countries are more homogeneous.

The three largest economies — the Czech Republic, Hungary, and Poland — are not only less developed than the EU-15 in trade facilitation as a whole, but also constrained in particular dimensions. Hungary's customs regime approaches 95% of the EU-15 level, while its ports efficiency does not exceed 60% of the this level. The Czech Republic is relatively developed in IT infrastructure but much less so in port efficiency. Poland, the least developed among the three, exhibits a level around 70% of the EU-15 benchmark in all the four areas. In sum, in order to achieve the trade facilitation levels of the EU-15, the new member and candidate countries have to overcome different challenges.

Large Gains from Behind–the–Border Improvements

The new EU members have exhibited rapid economic growth in the last several years (around 2.5-3%), despite the relatively weak performance of Western Europe and the world economy. Does economic growth enable building trade facilitation capacity? There may be a relationship, as the more developed a country is, the more resources it can devote to investing in trade facilitation capacity. By the same token, it is likely that the larger the economy, the higher the rate of return on investment in improving trade facilitation.

Yet, the gap in economic development of the EU-15 and the EU-8 and candidate countries does not fully account for the lagged progress in the latters' trade facilitation capacity. The only exception is Estonia, which performs stronger than the benchmark level in all four indicators but also has a far higher GDP growth rate than the regional average. Compared with Hungary, a country with similar economic characteristics, Estonia is 40% more developed in port efficiency, 30% in IT infrastructure and 20% in regulatory policy.

Does trade facilitation promote development? Our analysis suggests that barriers to trade facilitation in the EU-8 and the candidate countries may weaken their development potential. For example, export growth is one of the most important factors that contributed to recent economic growth in the Czech Republic, Hungary, and Poland. If infrastructure is upgraded and transactions costs lowered, trade volumes could be expanded.

Modeling the impact of hypothetical improvements in port efficiency, customs regimes, regulatory policy and IT by half of the EU-15 level on bilateral trade flows, we find that that behind-the-border factors will lead to the increase of import and especially export volumes. For example, the greatest absolute trade gains — US$49 billion and US$62 billion respectively — could be expected if port efficiency and IT infrastructure of the studied countries reach half the average level of the EU, and 70% of trade gains are associated with export expansion.

Improvements in behind-the-border factors by half of the EU-15 average also result in large relative trade gains of around 11%. For instance, Lithuania's trade volume would rise more than 25% if its IT infrastructure level reaches 50% of the EU level.

Trading Partners Also Benefit

Trade facilitation improvements benefit not only the countries that implement them, but also their trading partners. The more intense trade relations are between countries, the greater the potential benefit partner countries will enjoy. Given the importance of intra-regional trade between the EU-15 and the EU-8 and the candidate countries, the expected total trade gains to all of them may amount to almost US$10 billion if all four dimensions of trade facilitation improve by up to a half of the EU-15 level. Of these, 74% accrue to the EU-15 countries.

Almost 40% of the total estimated trade gains for the EU-8 and candidate countries come from improvements in IT infrastructure (see Figure). The second largest potential gains for EU-8 — almost 30% — come from port efficiency. These two dimensions should be therefore given a higher priority for improvement. Bulgaria, Romania, and Turkey receive more widely dispersed gains with investments in port efficiency, customs regimes and regulatory policy at around 20% of the total trade gains.

Improvements in trade facilitation in the New Member States and Turkey will also bring sizable benefits to EU15

In relative terms, the EU-8 and the candidate countries will benefit more than the "old" members, thanks to the existing relatively intense trade relationships. In particular, their relative trade gains are quite large should the largest economies among them — the Czech Republic, Hungary, and Poland — improve trade facilitation. For example, if Poland increases its IT infrastructure to half of the EU-15 average, the other seven new member countries will enjoy a trade gain of 0.8%; Bulgaria, Romania, and Turkey will gain 0.25%, and the EU-15 — 0.29%.

Concluding Remarks

As our analysis has shown, improvement in IT infrastructure could lead to the largest gains for the new members and the candidate countries. If clearance procedures could be streamlined, the attendant time could be shortened and costs saved.

In general, improvements in port facilities and IT infrastructure may be more costly than the administrative reforms at the center of customs regimes and regulatory policy — but they could have correspondingly high payoffs. The eligibility for additional EU financing with accession should provide more scope for improvements in these areas.

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Against this backdrop, a few suggestions for future work could be made.

All the Treaty provisions should, of course, be honored. Within this framework, however, taking a fresh look at the interpretation of the inflation criterion is possible. The three countries with the lowest inflation rates are not necessarily the three best performers of the EU-25. Indeed, it has been almost customary in recent convergence reports that two out of the three reference countries were ones with floating exchange rates that might not serve as the most suitable benchmark for joining the currency union. Thus, new ways should be explored, for instance, by taking into account the european Central Bank's explicit numerical target for calculating the reference value of the price stability criterion, or only looking at the inflation rates of eurozone members.

The new interpretation of the criterion would not set an unwelcome precedent for any future enlargements. It would demonstrate that the adoption of the euro would be assessed only by economic policy merits. Indeed, it is not entirely clear why a combination of low inflation and a fluctuating nominal exchange rate would be preferred to a strictly fixed rate when deliberating over eurozone membership.

It has been customary to ask what will happen if entry to the eurozone is indefinitely postponed. The Bank of Estonia's calculations put the economic costs of delay in terms of a cumulative loss in GDP growth at 10 percentage points over five years compared to the baseline. Of course, strong policies can reduce the impact of the postponement or even render it negligible. In any case, the fixed rate of exchange remains the sole anchor for Estonia's monetary policy. Over the medium term the inflation rate is expected to move closer to the eurozone average thus providing an opportunity to adopt the euro in the not so distant future.

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