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Trade Effects of EU Membership: Study Case onto the Romanian External Trade

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Abstract

In the past decade, Romania has been undergoing a unique change. As a result, in most cases, it is extremely difficult or impossible to separate the effects of EU integration from other components of the process. There are effects that would have appeared, even if accession to the EU was not a priority task. Accession to the EU does dramatically change the trade balance of Romania. Protective measures on EU imports were abolished, while some additional protection grows in the area of imports from third countries. However, the overall importance of tariffs and other restrictive measures further declines. Our economy becomes even more open, putting additional pressure on domestic enterprises, and also affects the state budget and certain policies of the state. It is important to create a motivating business environment, which enhances domestic production and raises the competitiveness of Romanian exports, through according not only direct support to exporters in form of loans and credits, but also a wide range of measures aimed at improving the business environment. In conclusion, a higher openness of the Romanian economy (expected now, after EU accession) may worsen the trade deficit, if it is not balanced by exports.

Key words: trade effects and challenges for new EU member states, Romanian external trade

1 – The New Status of Romanian External Trade Policy following EU Accession

1.1 – *External Trade in an EU Context*

Unlike in other areas, the EU has a common policy for trade. EU Member States have agreed to pool their sovereignty and pursue a common international trade policy that is designed to complement the creation and development of the internal market.

The European Commission acts as the leading voice in trade policy.

It is responsible both for conducting trade negotiations and for enforcing trade agreements: making sure that third countries comply with the rules and accords reached. The Council acts as the decision maker.

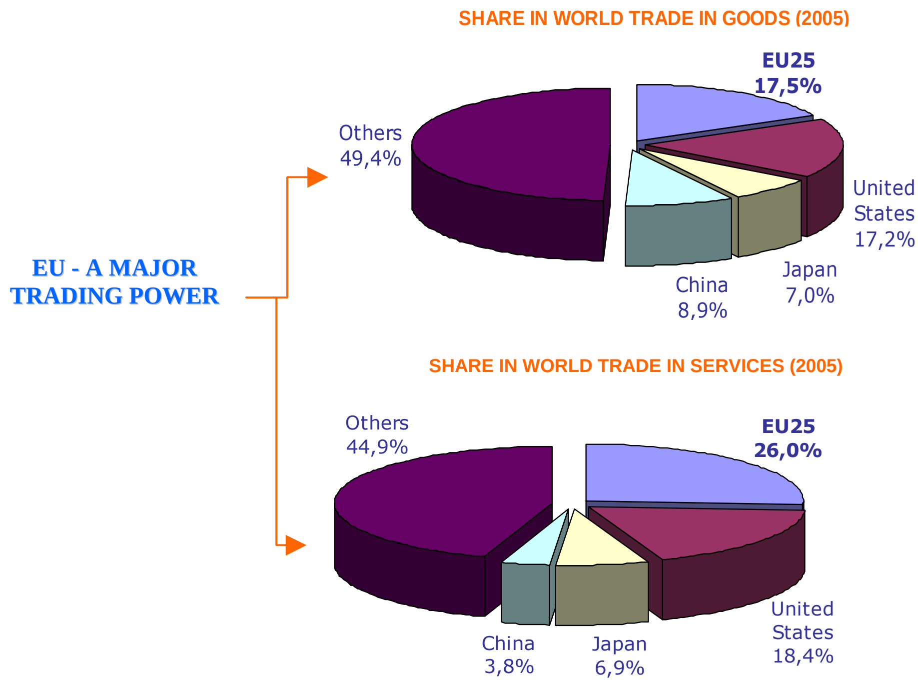
It guides the Commission in its work and then has the final say over whether or not to adopt an agreement.

The European Parliament monitors trade policy developments and is kept informed by the European Commission.

1.2. The EU Trade in Numbers

Though the European Union's 27 Member States represent a very small percentage of total world population (7,5%[1]), they account for more than a fifth of global imports and exports.

Graph 1



Source: EUROSTAT 2006 - International Trade Statistics

[1] Source: Eurostat/U.S. Bureau of the Census, January 1, 2007

EU trade policy is developed through two main channels:

- Multilateral level: this is the level of the World Trade Organisation (WTO), where the EU plays a crucial role.

- Bilateral agreements: in addition to multilateral negotiations taking place in the WTO, the EU concludes bilateral agreements (121 FTAs as of March 1, 2007) with regions and third (non-EU) countries. These agreements are legally binding for both parts. Depending on the level of integration they can be a custom union, free trade, association, co-operation and partnership. Some examples of bilateral agreements are as follows: Euro-Mediterranean Partnership, EU-APC Partnership Agreement, EU-US Transatlantic Economic Partnership, Free Trade Agreement with Switzerland, Association Agreement with Morocco, GSP etc.

1.3 – *Trade policy in the enlarged Europe*

It seems paradoxical, but the EU25's share of the world trade in goods and services, as well as its openness to trade (exports+imports/2*GDP) have declined slightly in comparison with those of the Union of 15.

The explanation lies in the exclusion of trade between the 15 and the 10 new members, which will then become intra-European trade.

The accession of the new members has not modified the hierarchy of the external trading partners of the Union.

As regards the Union's trading policy, accession of the new 12 members (including Romania) has had the following consequences:

- On May 1st 2004, respectively, on January 1, 2007, the acceding States applied all the trade agreements concluded by the Union, the Common External Tariff (C.E.T.) and the EU trade defence measures (anti-dumping, anti-subsidy) in force at that date. The application of the C.E.T. brings about a significant fall in the amount of customs duties these countries collected, as tariffs decreased from 9% to 4% on average. Moreover, the new members apply the preference systems (G.S.P., EBA - "everything except weapons" - initiative) which the EU has put in place. A number of the trade agreements which the Union has signed with Third Countries needed to be adapted. In particular, the quotas which remain in individual sectors (steel, textiles until the end of 2007, and specific measures for certain products from China) were increased in order to maintain the current existing trade flows between Third Countries and all the new members. Difficulties remained in the negotiation of steel quotas with Russia, Kazakhstan and the Ukraine.

- The new member countries gave up their own external trade policies. They had to rescind or amend any trade agreements they have concluded. Furthermore, Third Countries accepted that the agreements which they have signed with the EU15 will be automatically extended, which caused problems for the Agreement of Partnership and Cooperation between Russia and the EU15.

- The Commission is the only representative of the Union within the World Trade Organisation (WTO). The EU of 27 complied, of course, with all the rules of the WTO, including those relative with the Customs Unions (article XXIV 5 and 6 of the GATT). WTO members who can prove that EU enlargement results in a loss for them have been able to demand compensation. The negotiation process on this point continues at the WTO. But account will also be taken of the advantages enlargement will provide for Third Countries.

- Finally, concerning the trade between the 15 and the 12 new members, over 95% of its value was already duty free, because of the accession agreements or European Agreements already signed between the Union and the new members. The 5% remaining (certain agricultural products and processed agricultural products) was liberalised and/or came under the CAP regime.

1.4 – *Trade flows between EU and Romania up to now*

Following EU Accession, Romania withdrew from all free trade agreements. Romania's EU accession also means its adhesion to a new legal framework for external commercial relations. Following EU accession, Romania implemented the EU juridical framework.

Therefore, Romania concluded agreements with Mediterranean countries, Mexico, Chile, South Africa, signed the stabilization and association agreements with western Balkan states and the non-preferential agreements with third parties. Economic integration between the older Member States (EU15) and the New Member States (+12, including Romania) has been developing progressively. The New States quickly became the EU's second trade partner after the US, accounting for 12.3% of EU's total external trade. At the same time, the EU is the most important partner for the New Member States (including Bulgaria and Romania). In 2005, 68.1% of the Romanian total exports went to the EU, while 69.4% of our total imports came from the EU. In the same year, the EU's trade surplus with Romania amounted to €9,371 million. This trend can be seen in the *Table 1*, which depicts EU trade relations with Romania between 2000 and 2005.

But according to Eurostat[2] data from March 2007, in January 2007 the total Exports of Romania were €2.1 billion, increasing with 16% from the same month of 2006, while the Imports

[2] See News Release 42/2007 issued on 22 March 2007

amounted €3.3 billion, increasing with 36% from the same month of 2006, so we registered a Total Trade Balance Deficit of -€1.2 billion, a double-one compared with the same month of 2006. In the same period, for the whole EU, the first estimates for January 2007 were --€7.8 billion for the EA[3] 13 and -€26.2 billion for the EU27.

Table 1: Romanian Trade with EU

Year	Imports	Yearly % change	EU Share of total imports	Exports	Yearly % change	EU Share of total exports	Balance	Imports + Exports
2001	11 519		66.33	9 398		73.92	-2 121	20 917
2002	12 739	*10.6*	68.44	10 657	*13.4*	72.82	-2 082	23 396
2003	14 273	*12.0*	68.04	11 498	*7.9*	74.04	-2 775	25 771
2004	17 046	*19.4*	65.62	13 803	*20.0*	73.26	-3 243	30 850
2005	23 640	*38.7*	69.40	14 269	*3.4*	68.10	-9 371	37 909
3m 2005	4 797		69.57	3 458		71.84	-1 339	8 255
3m 2006	6 224	*29.7*	68.66	3 764	*8.9*	68.28	-2 459	9 988
Average annual growth		19.7			11.0			16.0

Source: EUROSTAT (Comext, Statistical regime 4)

2 – Who gains what in the enlarged EU?

Estimates of the impact of Romanian EU membership (like in all other New Member States) tend to be limited, taking into account its economic size. We can appreciate that Romania will benefit much more from its integration into the EU. The consensus amongst economists is that the gains are likely to be proportionately larger, reflecting the fact that almost 74%[4] of our exports go to the EU Member States and our economy is much smaller. As summarised in the economic literature, "trade induced simulations typically show that the applicants as a group gain everywhere from 1.5% to 8% or even 10% of GDP in the short to medium term".[5]

In sum, it can be said that trade within the enlarged EU will increase, mainly due to the importance of trade carried out between the current and the new Member States. The impact of enlargement on trade will, thus, be positive, although limited.

It should not be forgotten another important fact associated to trade and enlargement. In our view it must be stressed the positive impact that enlargement will have in strengthening the position that the EU has in international trade negotiations.

[3] EA = Euro – Area consisting of 13 Member States starting with January 1, 2007
[4] As of the year 2006, according to the Eurostat Statistical Yearbook, March 2007
[5] Pelkmans J. (2002), Economic Implications of Enlargement, *Bruges European Economic Policy* (BEEP) Series, Briefing No. 1, Bruges

The view that SMEs are less involved in international trade than larger companies seems to be valid for all EU countries. Even though there are differences between the Member States – for example SMEs in small and medium countries enjoy a much larger share of those countries' total exports than SMEs in large countries – the conclusion remains the same: EU accession will increase export opportunities for Romanian SMEs, as the new markets that arise are closer to them than other dynamic regions in the world, which attracted a large proportion of exports in the past.

However, if proximity plays such a crucial role for trade creation in SMEs as assumed, the gains from EU membership will concentrate on regions that are close to Romania such as Hungary, South-Eastern and Eastern Germany, or parts of Austria and Italy.

3 – Conclusions and Policy Implications

In the past decade, Romania has been undergoing a unique change. As a result, in most cases, it is extremely difficult or impossible to separate the effects of EU integration from other components of the process. Most of the effects of preparing for EU membership can be attributed to those of transformation or globalisation, and therefore they would have appeared, even if accession to the EU was not a priority task.

In general, the eastern enlargement of the EU was expected to be the most demanding, both for EU members, as well as the EU candidates from Central and Eastern Europe[6].

Our ex post simulation analysis concluded that changes in foreign trade relations are decisive for relative medium size economies, such as Romania.

Restrictive measures (e.g., import surcharge, certificates) were eliminated at EU accession, while some protective tools have been abolished already in the pre-accession period.

Our economy becomes even more open, which puts additional pressure on domestic enterprises to cope with competition, and also affects the state budget and certain policies of the state.

It is important to create a motivating business environment which enhances domestic production and raises the competitiveness of Romanian exports.

[6] Measuring direct effects of the accession process may be relatively easy, but it is much more difficult to identify indirect consequences, which may be often more relevant because of substantive multiplier effects of the adjustment that nations must take to prepare sufficiently for membership in the EU. These multiplier effects include economic multiplier effects of economic adjustment, such as the longer term budgetary consequences of redistributing resources in favour of integration. They also include cross-sectoral multiplier effects, for instance, when the economic adjustment process leads to non-economic multiplier effects, such as on the political, legal, social, and institutional spheres.

It is not only direct support to exporters in form of loans and credits, but also a wide range of measures aimed at improving the business environment in Romania (bank and enterprise restructuring, improved law enforcement, simplified procedures regarding establishment of companies, adjusting tax and transfer burden to levels which have motivating effects on the development of enterprises, etc.).

Accession to the EU does dramatically change the trade balance of Romania. Protective measures on EU imports were abolished, while some additional protection grows in the area of imports from third countries. However, the overall importance of tariffs and other restrictive measures further declines. To keep the trade deficit in moderate levels, specific policy implications can be summarised:

Support to FDI inflow. One of the factors that enhances positive effects of EU accession and contribute to reducing the negative impacts of the process for several sectors of economy is increased inflow of foreign direct investment. It appears that intensified capital flow has greater chances to reduce regional economic disparities within the EU than labour force migration. Since EU accession, we expect additional increase of FDI inflows, and a higher involvement of foreign investors in the manufacturing industry and particularly in the process of re-assessing and deepening the specialisation of production within the EU. Based on this assumption, the mutual trade should grow, resulting in improved net exports of Romania[7].

Enhancing cross-border cooperation. Regional cooperation should be a target in its own because it will undoubtedly improve overall competitiveness and thus also the readiness of Romania for deeper integration. Romania should gain economically from neighbourhood opportunities and enhanced cross-border cooperation with Hungary, Bulgaria, even Austria, Poland, and the Czech Republic (e.g., supported by EU's interregional programs). Lower transportation costs, better knowledge of demand and supply structures in neighbouring regions, proficiency in languages of the population living in border areas, and often also ethnic kinship across the border provide unused opportunities in Romania, as well[8].

Adoption of the euro. While there is not a full consensus on the medium-term implications of the European monetary union (EMU) for the euro-area growth, it is generally understood that EMU enhances productivity and growth within that area by reducing transaction costs, increasing allocative efficiency, eliminating exchange risk premia in interest rates, and boosting demand.

[7] The beneficial effects of FDI on the trade balance of the host country mainly occur via increased exports due to the production of more competitive products and to the utilization of the distribution networks and the marketing-related know-how of the foreign investor. Foreign direct investments may mean a relief of the pressure on foreign exchange funds of the host country also in cases when the production of goods is taken care of which previously had to be imported. The Romanian experience suggests that foreign investors doing business in our country have beneficial effects on exports as well as on the balance of payments.

[8] According to Altmann (1996).

The degree to which changes in economic activity will affect export growth in Romania will obviously depend on the degree of trade openness of Romania's and on the share of Romania's sells directed to the EU. In sum, EMU has the potential to bring important trade benefits to our country, although it will also pose new challenges. To boost the positive effects of a single currency union, the most convenient for Romania would be to adopt the euro and enter the EMU at the earliest possible date.

Use of structural funds. Since our accession to full-membership, Romania is entitled to access EU's structural funds. The allocation of these funds, and a rational use of EU's financial assistance may strengthen the export potential of domestic production and positively influence the trade balance.

In conclusion, as our ex post analyses confirmed, a higher openness of the Romanian economy (expected now, after EU accession) may worsen the trade deficit, if it is not balanced by exports.

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