ARTICLES

EU Accession of Bulgaria and Romania

Yoji Koyama

1. Introduction

Bulgaria and Romania were admitted to the European Union (EU) on January 1, 2007, thus making their long-cherished desire into practice. It was not easy path for the both countries to reach this date. Due to their worse political and economic performance, the both countries were not admitted to the EU on May 1, 2004 together with 8 Central European and Baltic countries. Their accession delayed for two years and 8 months.

Ialnazov (2000) mentions initial conditions of transition and political changes as causes of Bulgaria's inferior performance, and attaches importance to the following initial conditions: a) relatively low degree of marketization and non-existence of anti-Establishment movement in the socialist period; b) a huge amount of external debt inherited from the centrally planned economic system, and the industrial structure which required import of a large quantity of raw materials and energy; c) Strong dependence on foreign trade with COMECON countries, especially with the Soviet Union; d) disadvantageous location such as the Balkan Peninsula (p. 2).

Points a) and d) applies to Romania just as they are. Point b) does not apply to Romania because during the last years of the Ceausescu regime Romania made a desperate effort to repay its external debt and consequently there

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was no necessity for repay at the time when the country started the transition to a market economy. In addition, as Romania had oil and natural gas resources its circumstances were somewhat different from Bulgaria, but it can be said that similarly Romania had resource-wasting industrial structure which was specific to the centrally planned economic system. Point c) does not apply to Romania. Because this country has taken a unique position in the COMECON regime since the early 1960s, and therefore the country's dependence on foreign trade with the Soviet Union was relatively low and its dependence on foreign trade with West European countries was relatively high. Only in 1980s the country increased its dependence on foreign trade with the Soviet Union to some extent.

A characteristic feature common to the both countries is Point a). Although during the last years of the socialist period Bulgaria tried to adopt some elements of market economy following the Perestroika in the Soviet Union, resistance by conservative forces was so strong that the reform was inconsistently implemented and the economic crisis deepened, leading to "the economic situation immediately before a coronary thrombosis" (Iwabayashi, 1999, p. 245). In the case of Romania, there has been almost no effort to adopt some elements of market economy during the socialist period. What can be said in common is that almost no anti-Establishment movement has been bred during the socialist period and consequently forces which should have led the transition to a market economy were very weak after the system change. Therefore, in the both countries reforms turned out inconsistent, and the "transformational recession" has prolonged. Moreover, their economies which made upward turn in mid-1990s have stalled again, leading to the second transformational recession between 1996 and 1999.

Ialnazov (2003) argues that countries which escaped from socialism with "coup d'etat by nomenklatura" tend to be partial reformers, and the result has been a vicious circle of corruption and rent-seeking, locking these

countries into a "bad" post-socialist trajectory. He says, in order to extricate themselves from their post-socialist trajectory "external anchors" are necessary (Ialnazov, 2003, pp. 85-88). For Bulgaria the first "external anchor" is the currency board system, and the second "external anchor" is its prospect for the EU accession. Bulgaria adopted the currency board system in 1997 while Romania did not. What the both countries have in common as the "external anchor" is their prospect for the EU accession. The reason for why the EU changed its policy toward South East European countries (SEECs) seems to be that the EU perceived it necessary for the EU itself to lead reforms in SEECs including Bulgaria and Romania.

In this paper I will describe the progress to a market economy in Bulgaria and Romania, their present economic situation, efforts to the EU accession and challenges for the both countries after the EU accession.

2. Transition to a Market Economy in Bulgaria

2.1. Lukewarm Reforms

It was not anti-Establishment elite but a part of the ancient regime that came into power after the collapse of communism. The old communist party changed its name into "Socialist Party" in March 1990, but it did not change its character into that of Social Democratic Party as was the case in Central Europe. A conservative group, which insisted on protection and support of state-owned enterprises, regulation of prices and maintenance of social security system inherited from the socialist regime, became the mainstream of the party. Another group which came from the old communist party formed Union of Democratic Forces. Thus two big party, that is, Socialist Party and Union of Democratic Forces have emerged. Since then keen struggles for power have been repeated between these two parties. Between February 1990 and April 1997 elections of the National Parliament were held for four times

and the change of government occurred for nine times. Every time the change of government occurred almost all the managers of state-owned enterprises and workers of administrative offices were replaced regardless of their ability and performance (Ialnazov, 2000, p. 3).

Another product of the system change in this country was "politicization of transition economy". "A part of the nomenklatura of the Communist Party was able to change to new elite. In addition, through suction of assets in state-owned enterprises or transformation of bank loans into bad debts a majority of the nomenklatura has accumulated enormous amount of wealth and came to have big influence on economic policies in order to protect their interests" (Ibid., p. 3).

He adds, "in the climate of overall economic liberalization and political appointment the economic administration was so weak that it was no match for interests of emerging business circles. As a result of increased influence of the politics over the economy, the government has lost its power to manage the economy and became unable to provide people with basic public goods such as protection of property rights and contract rights as well as implementation of laws and regulations. During the period 1989-1997 Bulgaria became a country where criminal organizations provided people with such public goods instead of the government and informal economy and corruption prevailed" (Ibid., p. 4). Describing characteristics of the Bulgarian society, Ialnazov points out a similarity between Bulgaria and Russia.

With 1993 as a bottom the economy seemingly made an upward turn between 1994 and 1995, but the country was struck by a serious economic crisis from 1996 through 1997. In 1997 the inflation rate exceeded 1000%. Causes of the economic crisis in the second half of the 1990s can be considered as follows:

The government lacked strong political will to promote painful reforms such as big scale privatization and restructuring of state-owned enterprises.

Caporale (1999) finds serious problems in the points that virtually no foreign investors have participated in the privatization process in 1992-1997 and that the biggest share of the privatized assets were acquired by working teams, tenants and farmers. Since their main concern was maintaining high levels of employment as well as high salaries and social benefits, it is hardly surprising that productivity in such enterprises was badly affected and they run into debt (p. 219).

According to Ialnazov(2000), government subsidy to state-owned enterprises should have been practically cut off by the "shock therapy" and eco-

Table 1 Bulgaria's Macroeconomic Indicators, 1990-2006

	1990	1995	2000	2001	2002	2003	2004	2005	2006
Population (10 thousands)	872	840	817	791	787	782	780	770	770
GDP real growth rate	-9.1	2.1	5.4	4.0	4.8	4.5	5.6	5.8	5.5
Industry real growth rate	-16.1	-6.3	12.0	0.7	4.0	18.3	21.5	7.3	n.a.
Agriculture real growth rate	-3.7	14.0	-9.1	-0.1	4.2	-1.4	5.6	-8.6	n.a.
GDP/capita (US$, exchange rate)	1,343	1,538	1,546	1,718	1,984	2,546	3,109	3,381	n.a.
Unemployment	1.5	10.5	16.4	19.5	16.8	13.7	12.0	9.9	n.a.
Consumer prices	26.3	62.0	9.9	7.4	5.9	2.3	6.1	5.0	3.5
Interest rate (Base rate)	n.a.	n.a.	4.7	4.7	3.4	2.9	2.4	2.1	n.a.
General government budget balance/GDP	n.a.	-6.4	-0.5	1.4	-0.2	0.6	1.3	2.4	3.0
Trade balance/GDP	n.a.	1.0	-9.2	-11.7	-9.4	-11.0	-12.4	-20.8	n.a.
Current account/GDP	-2.0	-0.2	-5.6	-7.3	-5.3	-9.3	-8.5	-14.9	-7.4
FDI (US$ million) Inflow	n.a.	82	998	803	876	2,070	1,232	1,991	2,106
Stock	4	337	2,257	2,758	3,662	5,082	8,200	n.a.	n.a.
External debt/GDP	n.a.	n.a.	88.6	78.4	72.7	67.7	69.3	68.2	n.a.

Source: EBRD (1997), p.219; EBRD (2005), p.117; EBRD (2006), p.37; For FDI stock WIIW (2005), p.19.

nomic entities should have faced "hard budget constraint", but after the start of the reform budget constraint has gradually become softened. Concretely speaking, the failure of two main transition policies brought softening of budget constraint: First, the disposal of state-owned enterprises' bad loans, which have been accumulated under the centrally planned economy, has been delayed. In the end banks were obliged to bear a part of them, allowing the preservation of inefficient enterprises. Second, the big-scale privatization and restructuring of enterprises were postponed, resulting in continuation of tacit subsidies to loss-making state-owned enterprises (pp. 5-6).

Under pressure to relief major banks and depositors the government was obliged to issue national loans again in 1995 and 1996. As a result, the budget deficit as percentage of GDP expanded from -6.6% in 1995 to -16.6% in 1996. In 1995 many people have lost their deposits due to the collapse of "pyramid schemes", and an informal forecast that several banks might go bankrupt has spread. In December1995 a monetary panic occurred. After the Central Bank closed two major banks and began their bankruptcy procedure in June 1996 the Bulgarian economy became exposed to waves of the panic (Ibid., pp. 6-7).

2.2. Introduction of the Currency Board System

In November 1996 the IMF proposed the Currency Board System to the BSP government as a tool to ensure financial discipline and macroeconomic stabilization. As the economic crisis deepened, the idea gained wide popularity. By the time the BSP government resigned and an interim government took office in early February 1997 all major political parties had announced their support for the introduction of the Currency Board System. In April the UDF government won the elections for the new parliament, and its government launched the currency board in early July 1997 with a start-up loan from the IMF as part of necessary foreign currency reserves (Ialnazov, 2003, p. 91).

Under this system the money supply must be 100 percent backed by the foreign currency reserves. In July 1997 the lev (BGL), a unit of the Bugarian Currency, is absolutely fixed to the German mark at the rate of 1 DM = 1000 BGL (or 1 DM = 1 denominated BGL as of July 1999). The Bulgarian National Bank has lost most of the traditional powers of a central bank, and it is now responsible for currency stability and monetary issue, as well as external balance, repayments on external debts, and regulation of banks. BNB is no longer allowed to give loans to government and banks. Therefore, soft financing of loss-making state-owned enterprises through banks and compensation of budget deficit by central bank's loans became impossible. It can be said that the currency board system is a mechanism for de-politicization of economy and restoration of credibility of the government (Ialnazov, 2000, p. 9; Caporale, 1999, p. 222).

Since the currency board system attaches macroeconomic stability, it is a very severe system. As a result of the introduction of this system, the inflation was drastically calmed down. As budgetary discipline was tightened the budgetary deficit, which recorded as high as 10.5% of GDP in 1996, has decreased, leading to budgetary surplus of 1% of GDP in 1998. All these augur well for the economy. However, we should not overlook that although the unemployment rate decreased from 13.7% in 1997 to 12.2% in 1998, it soared to 17.9% in 2000.

3. Transition to a Market Economy in Romania

3.1. 'Stop-go Transformation' Process

After the fall of Ceausescu regime in the late December 1989, Front for Salvation of the Country seized power. Under the cruel regime of Ceausescu anti-Establishment intellectuals were entirely suppressed and citizen's movement were nipped in the buds. This is why the vacuum of power was instantly

filled by the ex-communists elite who were coldly treated during the last years of the old regime such as Iliescu and Petre Roman. In Romania there was not a move of power supported by citizen's movement from below like in Poland, but simply a horizontal move of power. Thus the transition to a market economy was promoted by the Government composed of the Front with the ex-nomenklatura as its center.

"Adjustment program", which was published in August 1990, was quite similar to Russia's "500 days' plan" in the point that the former aimed to prepare within 640 days legislation and institutions necessary for the transition to a market economy. Compared with "500 days plan", however, Romania's "Adjustment program" did not take into account macroeconomic stabilization. According to Yoshii (2000), the reason is ascribed to a difference in initial conditions of the economic performance. As Ceausescu adopted a strategy to swiftly repay foreign debts in the 1980s, there was a surplus in the trade balance in the early 1990s. Also there was no superfluous liquidity at that time, so that necessity of macro economic stabilization was not so acutely felt (Yoshii, 2000, p. 69).

In this way the system transformation began in Romania, but it was "stop-go transformation" (Hunya, 1999, p. 1). The Presidential election and elections of the Upper and Lower Houses were held in autumn 1992. The winners were Iliescu and Democratic Front of Salvation of the Country, who "seriously viewed negative factors in the process of transition to a market economy and advocated to slow down the speed of transition and provide careful social protection (Yoshii, op.cit, p. 65). The reform process was characterized by 'pathological gradualism' (Hunya, 1999, p. 3).

International Support Organizations including IMF expressed their dissatisfaction with sluggish privatization in this country. The Government of Romania was urged to accelerate the large scale privatization. The Law on Acceleration of Privatization was enacted and came into effect in June 1995.

Even with this, however, the transition to a market economy did not make a great progress. As Yoshii points out, "In the second round of privatization in Romania the state possessed a majority of shares of companies and tried to control big companies and strategic companies" (Yoshii, 2000, p. 117).

In the elections of Parliament and President the opposition group 'Democratic Congress' won. The new government made a strenuous effort in promoting the transition to a market economy with aim of the EU accession. However, the economic performance was further aggravated and the trade deficit increased. Debt service reached its peak in the first half of 1999, and possibility of default was being whispered around at that time.

Table 2 Romania's Macroeconomic Indicators, 1990-2006

	1990	1995	2000	2001	2002	2003	2004	2005	2006
Population (10 thousands)	2,321	2,268	2,244	2,241	2,174	2,174	2,170	2,160	2,160
GDP real growth rate	-5.6	7.1	1.8	5.3	4.9	4.9	5.2	8.3	5.0
Industry real growth rate	-23.7	10.0	8.2	8.3	4.3	3.1	5.3	2.1	n.a.
Agriculture real growth rate	n.a.	4.5	-14.1	22.7	-3.5	3.0	-	-13.9	n.a.
GDP/capita (US$, exchange rate)	1,257	1,579	1,652	1,793	2,100	2,638	3,376	4,295	n.a.
Unemployment	n.a.	9.9	7.1	6.6	8.4	7.0	6.3	5.9	n.a.
Consumer prices	5.1	32.3	45.7	34.5	22.5	15.3	11.9	9.5	7.5
Interest rate (Discount rate)	n.a.	34.1	35.0	35.0	29.0	20.4	18.0	7.5	n.a.
General government budget/GDP	1.0	-2.6	-3.8	-3.5	-2.0	-2.0	-1.4	-0.8	-1.4
Trade balance/GDP	-7.0	-5.7	-4.5	-8.0	-5.8	-7.6	-8.0	-11.3	n.a.
Current account/GDP	-6.7	-5.0	-3.6	-5.8	-3.4	-6.0	-7.5	-9.3	-10.6
FDI (million) Inflow	n.a.	404	1,051	1,154	1,080	2,156	5,020	5,230	4,480
Stock	n.a.	971	6,480	7,638	7,799	12,815	18,002	n.a.	n.a.
External debt/GDP	n.a.	n.a.	28.8	30.9	35.0	36.0	36.2	34.8	n.a.

Source: EBRD (1997), p.232; EBRD (2006), p.63; For FDI stock WIIW (2005), p.19.

In November 2000 the Presidential election and the general elections were held. At that time the country was in the midst of the second transformational recession, and reformist parties were in a difficult campaign. In the Presidential election no candidate won a majority. The final ballot was held between Tudor, who stirred up Romanian nationalism, and ex-President Iliescu. After all, Iliescu, who was one of the communist elite, won and made a comeback as the President. It is said in Romania that between two evils Romanian people chose less evil. This was an event that symbolically showed difficulties in the transition to a market economy in Romania. In response to the results of the elections a one-party cabinet of the Social Democratic Party led by Mr. Nastase was formed.

4. Present Economic Situation: Bulgaria and Romania

In the both countries the economies showed upward turn around 2000, and since then the robust economic growth has been continuing.

4.1. Bulgaria

In 2000 Bulgarian economy began developing, with GDP growth of 5.4%. It was mainly due to an increase in FDI inflows. As for the increase in FDI inflow, Dr. Tsvetan Manchev, Vice Governor of the National Bank of Bulgaria, stresses the success of economic reforms. The successful turn in capital flows can be primarily attributed to the abrupt changes in the capital flow management and the sharp rearrangement of the legislative, accounting, informational framework with the purpose to meet the EU criteria for membership before the end of 2006. The Government adopted the credible economic and financial policy supported by a medium-term stand-by arrangement with IMF, and has prepared liberal trade and investment climate. In 1996 Bulgaria became a member of the World Trade Organization.

Bulgaria restarted liberalization of trade at a slow pace, but later on the process picked up speed. Since then the country has made significant progress in the sphere of telecommunications and financial services liberalization and to a lesser in improving the access of foreign goods to the local market. The Foreign Exchange Law (1999) and regulations are now fully compliant with the EU Directives. Foreign investors can repatriate profits freely. Currently foreign and domestic investments are treated on an equal basis. The constitutional problem prohibiting the acquisition of direct title by foreigners of real estate and land is partially resolved. Joint ventures or 100%- foreign owned companies registered under the Bulgarian law are allowed to buy land for business purposes (Manchev, 2005, pp. 335-338).

The Government has endeavored to pursue sound macroeconomic policies. Since mid-1997 the prudential fiscal policy has helped to constrain the budget deficit. It was initially designed to keep an annual general government budget deficit of around 1-1.5% of GDP. The post-privatization reforms after September 2001 allowed for the deficit to decline or for the government even to maintain a slight surplus. Such a sound government budget in recent years was connected with the following factors: (1) the improved revenues collection; (2) the optimization of both interest and non-interest expenditures through an active public debt management and the reform of social security, pension and health care systems; (3) the consolidation of extra-budgetary accounts and implementation of a "single budget account" procedure contributing to a more efficient cash flow management and (4) the sharp and pre-announced decrease in the overall tax burden in 2002-2004 (Ibid., p. 339).

The public and publicly guaranteed debt fell down dramatically without any visible damage on the growth and socio-economic cohesion, decreasing from more than 100% of GDP at the end of 1997 to about 41% at the end of 2004. The stability of the currency board arrangement and the steady

progress in the reduction of gross external debt further provided for relatively low inflation and the subsequent stability of the real interest rates. In a currency board environment the desirable convergence of domestic interest rates toward the average euro-zone levels occurs (Ibid. pp. 340-341).

During the period due to the income policy adopted by the government the wage increase has been restrained. Bulgarian people had to endure pain from the reforms. The wage bill in a number of loss-making enterprises and large state monopolies was held down (p. 343).

FDI inflow amounted to US $ 1 billion in 2000, decreasing slightly to US $ 0.8 billion and US $ 0.9 billion in 2001 and 2002 respectively. However, it jumped to US $ 2.1 billion in 2003 (see Table 1). When we look at the FDI inflow stock as of the end of 2004, we find that Manufacturing accounts for the biggest share (27.5%), followed by Wholesale, retail and automobile repairing, etc. (18.5%), Financial intermediation (14.7%), Transportation, storage and communication (13.2%), Electricity, gas and water (11.2%) (WIIW, 2005, p. 70). Among manufacturing the textile, footwear and clothing industries, which have had comparative advantage, have attracted the biggest amount of FDI in recent years. These industries are increasing their exports. To a lesser extent the pharmaceutical industry, chemical and petro-chemical industries, mechanical and electrical engineering, as well as metallurgy have attracted a considerable amount of FDI (Manchev, 2005, p. 345).

Current account deficit has been rather big, but FDI inflow has sufficiently covered it. Since 1997 foreign direct investment to gross fixed capital formation has fluctuated between 32% and 52% (Ibid., p. 347). This ratio is the highest among Central and East European countries and this fact demonstrates that FDI has played a crucial role in the economic development especially in Bulgaria.

From the above mentioned, Manchev stresses that Bulgarian experience in the transition fully proves the close interrelation between the trends of

foreign investment inflows and the pace of structural reforms in many respects (Ibid., p. 344).

4.2. Romania

Year 1999 was the worst. According to Hunya (2002), in 1999 the worst-case economic scenario - i.e. the country defaulting on foreign debts - was only avoided by domestic borrowing and abandoning the inflation target previously set. Devaluation played an important role in diminishing consumer goods import. It also fueled inflation and stimulated exports (p. 5). In 2000 GDP increased 1.8% with a sign of upward turn, followed by 5.3% growth in 2001.

The resumption of economic growth was fuelled by external demand (export). The export surged from US $ 8.4 billion in previous year to US $ 10.4 billion in 2000 and US $ 11.4 billion in 2001. In 2001 the economic development was stimulated also by domestic demand. From 1999 through 2002 FDI inflow remained US $ 1 billion or US $ 1.1 billion annually. They came mainly neither as new green-field investment projects, nor were there significant privatization revenues. FDI came mainly during the post-privatization restructuring in the form of foreign take-over or capital increase of privatized companies (Ibid., p. 5).

Privatization has been hesitantly implemented. With utilities included, only about 15% of all large enterprises' assets were privatized by 2000. The banking sector reform started late but was more effective than industrial restructuring. As of December 2000, there were 33 fully licensed banks in Romania of which four were state-owned and two of which were privatized in the following year. There were also 21 foreign-owned banks among them. During the process of bank restructuring since 1998 bad debts have been either written off or shifted to a state agency. As a result, the size of overdue and doubtful loans in percent of the own capital of banks has drastically

decreased from over 250% in 1998 to 31% in 1999 and below 5% in 2000. The same debts as a percent of all banking assets decreased from 16% to 0.5%. The capital adequacy ratio in the banking sector increased from 6% in 1998 to 10% in 2000. Thus the Romanian banking system is now cleaned from the old portfolios and the remaining state banks can more easily go private (Ibid., p. 6).

FDI inflows jumped to about US$ 2.2 billion in 2003 and about US$ 5.1 billion in 2004. As of the end of 2004 FDI stock amounted to US$ 18 billion, of which manufacturing account for 51.6%, followed by Hotel and Restaurant (16.2%), Wholesale, Retail, Automobile repairing, etc (11.4%), Transportation, Storage and Communication (9.2%), and Financial intermediation (6.6%) (WIIW, 2005, p. 78).

The reasons for why FDI inflows increased since 2003 can be considered as follows: First, political and economic stability of the country increased than before; Second, prospect of EU accession was becoming more realistic; Third, privatization of utilities and large state-owned enterprises gained momentum in this country while privatization process in Central European and Baltic countries has almost completed; Fourth, as Hunya explains using Flying Geese theory, a considerable amount of FDI has flowed into Central European countries from West European enterprises in 1990s, but labor cost has been gradually increasing. Instead, low-technology and labor-intensive industries in Romania have been attracting FDI. Some multi-national enterprises shifted their production basis from Hungary to Romania.

I am afraid that data are little bit too old, but as of 2000, with only US$ 2 billion foreign capital invested, foreign affiliates produce 38.6% of manufacturing turnover, employ a quarter of the manufacturing labour force and account for 44% of the direct manufacturing exports (Hunya, 2002, p. 17). Presumably, at present share of foreign affiliates is much higher by any indictors.

Hunya worked out a table which listed 10 biggest gaining industries and 10 biggest losing industries in Romanian exports to the EU-15 during the period 1995-2000. According to the table, industries which had the biggest exports and the biggest gains (competitive gain) during the period are Wearing apparel and accessories, and Footwear with their market share in EU-15 being 5.45% and 9.32% respectively. On the other hand, industries which had the biggest decrease in competitive gain during the period are Basic iron and steel, ferro-alloys, and Furniture with their market share in EU-15 2.84% and 3.98% respectively (Ibid., p. 15). The textile and leather industries have had comparative advantage and have had big market share in EU-15 markets. These two industries have attracted foreign capital which then helped to increase exports further. Hunya measured the degree of foreign penetration in Romanian economy by share of foreign affiliates in manufacturing industry sales, and he compared the degree of foreign penetration in Romania, Czech Republic and Poland. In Romania foreign penetration is higher in textile and leather industries while in all other industries, foreign penetration in Romania is smaller than in the Czech Republic and Poland. It is particularly low in furniture industry. It seems that this industry is not attributed much future by foreign investors (Ibid., pp. 19-20).

When we pay attention not to absolute amount of exports but to share of foreign affiliates in exports electric machine industry had the highest share with slightly more than 70%, followed by transport machine (about 65%), leather industry (slightly more than 60%), textile and clothing industries (slightly less than 50%), and basic metal industry (about 45%) (Ibid., p. 23).

According to Hunya, Foreign investors support Romania's traditional specialization in clothing, footwear and metals. They are the driving force behind the emergence of exports in the electrical machinery and electronics sector (Ibid., p. 24).

5. Progress in Path toward EU Accession

Compared with Central European countries and Baltic countries, Bulgaria and Romania were late reformers. In Agenda 2000, which was published in 1997, the both countries were placed as the second wave. After having experienced the Kosovo war, the EU felt it necessary to change its policy toward South Eastern Europe. In order to give SEECs brighter prospect, the EU Council of Ministers in December 1999 decided to open EU accession negotiation for Bulgaria and Romania, and it had a further "catalytic effect on the momentum for reform" (Dragan, 2006,). The official accession negotiations for Bulgaria and Romania as well as other countries which joined the EU in 2004 were launched on February 15, 2000. Since then the both countries have endeavored to implement reforms so as to be admitted to the EU.

Let us compare the 1997 version and the 2005 version of Transition Report published by EBRD and confirm to what extent reforms have advanced during the period 1997-2005. I would like to add Croatia to this comparison because in recent years Croatia as an EU candidate has been often discussed together with Bulgaria and Romania (see Table 3 and Table 4). When we look at private sector share of GDP, Bulgaria has made the biggest progress during the period (from 50% to 75%). In terms of other indicators, Croatia was in equal position or ahead of Bulgaria and Romania as of 1997, but the three countries are almost in line as of 2005. In terms of small-scale privatization, governance and enterprise restructuring, banking reform and interest rate liberalization, and securities markets and non-bank financial institutions, Croatia remains ahead of the other two countries while in terms of other sectors it is in line with or even lagging behind the two countries. In its 2004 Report the European Commission concluded that Romania complies with the criterion of "functioning market economy", a prerequisite for the

Table 3 Progress in Transition in 3 South East European Countries (1997)

	Population (millions, mid-1995)	Private sector share of GDP in %, mid-1997	Enterprises			Markets and trade			Financial institutions	
			Large-scale privatization	Small-scale privatization	Governance & restructuring	Price liberalization	Trade & foreign exchange system	Competition policy	Banking reform & Interest rate liberalization	Securities markets & non-bank financial institution
Bulgaria	8.4	50	3	3	2+	3	4	2	3−	2
Romania	22.7	60	3−	3	2	3	4	2	3−	2
Croatia	4.8	55	3	4+	3−	3	4	2	3−	2+

Source: EBRD (1997), p.14.

Table 4 Progress in Transition in 3 South East European Countries (2005)

	Population (millions, mid-2005)	Private sector share of GDP in %, mid-1997	Enterprises			Markets and trade			Financial institutions		Infrastructure
			Large-scale privatization	Small-scale prevatization	Governance & restructuring	Price liberalization	Trade & foreign exchange system	Competition policy	Banking reform & Interest rate liberalization	Securities markets & non-bank financial institution	Infrastructure reform
Bulgaria	7.8	75	4−	4−	3−	4+	4+	3− ↑	4−	2+	3
Romania	21.4	70	4−	4−	2+ ↑	4+	4+	2+	3	2	3+
Croatia	4.4	60	3+	4+	3	4	4+	2+	4	3−	3−

Source: EBRD (2005), p.4

Note: Here category 1 means little progress. Category 4+ is the highest and means standards and performance typical of advanced industrial economies. ↑arrow indicates change from the previous year in that sectoral transition indicator. One arrow indicates a movement of one point (from 2 to 3-, for example).

EU entry, although the Report expresses a number of concern about the Romania's capacity to cope with the competitive pressure and market forces within the Union. The EU accession negotiations for these two countries were closed in December 2004, and the Accession Treaty for Bulgaria and Romania was signed in April 2005. From the above-mentioned it may be safely said that the "external anchors" which have been necessary for Bulgaria and Romania to extricate themselves from "bad" post-socialist trajectory, namely, the currency board system (for Bulgaria) and the prospect of the EU accession (forbothBulgariaanRomania)havesatisfactorily played their roles.

However, Bulgaria and Romania are facing big challenges, that is, fighting against organized crimes and reforms of the judicial system. When I visited Sofia and made a field survey in March 2005 I made an interview with an economist who was working at a NGO. I asked him, "What is the biggest problem which Bulgaria is facing now?" He mentioned weak judicial system. According to his explanation, excellent students who graduated from Law Faculties of Universities are willing to work at companies while courts felt it difficulty in employing excellent lawyers. It is said that the police has been very weak and has had connection with criminal organizations underground. Therefore, the police cannot arrest criminals. Even if it arrests criminals it takes too long time for courts to deliver judgements[1].

The EU has been worried about a delay in fighting against corruption and organized crimes in the both countries, and added four safeguard clauses to the Accession Treaty. A fourth clause included in the Treaty allows the Council to decide, based on the European Commission's recommendation, the accession would be postponed by one year in case where there is clear evidence that the state of preparation for adoption and implementation of the *acquis* is such that there is a serious risk of Bulgaria/Romania being manifestly unprepared to meet the requirements of membership in a number

of important areas[2]. Finally, in September 2006 the European Commission decided to admit the two countries on January 1, 2007 as planned, but with qualifications: Even after their accession the EU will continue to monitor areas such as agriculture, corruption, reform of judicial system, rights of intellectual property and border control where the two countries are lagging behind the EU standard.

Croatia's accession to the EU is expected to be around 2010. According to indicators of progress in transition in EBRD's Transition Report 2006, Croatia is almost in line with Bulgaria and Romania, and in addition, Croatia is much richer in terms of per capita GDP. Nevertheless, Croatia was left until later. It is mainly due to the EU's political judgement that Bulgaria and Romania preceded Croatia in EU accession. Namely, Croatia has been negatively affected by its involvement in ethnicity conflicts of the former Yugoslavia while in the case of Bulgaria and Romania already in December 1999 the EU decided its basic line that the two countries would be admitted in the near future. Presumably, the European Commission took into account domestic affairs in the two countries. In Bulgaria, for example, ultranationalist party 'Ataka', which called to outlaw the ethnic Turkish Movement For Rights and Freedom (MRF), came fourth in 2005's parliamentary elections. In the first ballot of the Presidential election held in October 2006 a candidate from 'Ataka' gained 20% of the total votes. In the second round run-off held in the end of October 2006 Mr. Parvanov, incumbent President, and Ataka's candidate competed each other, and Mr. Parvanov won re-election, gaining three-quarters of the vote. Polling decreased from 64% in the first round to 42.1% in the second round, reflecting the poor performance of the centre-right and reform fatigue (*Emerging Europe Monitor*, Dec. 2006, pp.1-4). There might have been an alternative option - postponing accession by one year. However, judging "This would have been more likely to increase political instability and breed anti-EU

sentiment that would stymie progress even more" (*Emerging Europe Monitor*, Nov. 2006, p.5), the European Commission decided to admit Bulgaria and Romania in January 2007 as planned.

6. Challenges for the Two New EU Member Countries

One of the biggest challenges for the two countries after accomplishing the EU accession is to enter the EMU (Economic Monetary Union) and adopt Euro as soon as possible. For that purpose the two countries must satisfy the Maastricht criteria. Governments of the two countries are required to pursue prudent fiscal and financial policies in their economic development.

In addition, the two countries have a huge amount of trade deficit. In Bulgaria the trade deficit in percentage of GDP increased from -12.4% in 2004 to -20.8% in 2005. In Romania the trade deficit in percentage of GDP increased from -8.0% in 2004 to -11.3% in 2005. Although such huge amounts of trade deficit have been partly covered by FDI inflows, the current account deficit has been still at high level (-14.9% in Bulgaria and -9.3% in Romania). The both countries will have to overcome such structural fragility of their economies.

Although being admitted to the EU, it was conditional. As mentioned above, the two countries will be monitored by the EU in several areas where the two countries are lagging behind the EU standard. In order to win the confidence of people in the existing member of the EU the governments of the two countries have to tackle the reform of judicial system and fight against organized crimes with their full strength.

Regulation on migration to EU-15 is being reinforced. Prior to the EU enlargement in 2004, the existing member of the EU (EU-15) decided that they might take transitory arrangements for nationals migrating from the

new member states to be substantially limited the possibilities of work up to seven years. UK, Ireland and Sweden did not use this right and have immediately opened their labor markets. As a result, migrants from EU-8 concentrated mainly to UK. Business circles in UK have welcomed labor migration on the ground that it enhanced economic growth. However, migration of a great number of workers, which exceeded prior anticipation, repelled people in the second half of 2006. In October 2006 the British government launched a new policy to limit migration from Bulgaria and Romania. According to this new regulation, other than skilled workers the number of workers will be limited up to 20,000 annually, and only in food processing industry and seasonal agricultural labor. An illegal immigrant shall be fined up to 1000 pound as penalty (*Mainichi Shimbun*, December 21, 2006; *Asahi Shimbun*, January 4, 2007).

It is natural for Bulgarians and Romanians to be dissatisfied with discriminative treatment from nationals of the EU-8. Turning our eyes to domestic affairs, however, the tendency of decreasing population has been continuing since the beginning of the transition to a market economy in the both countries, notably in Bulgaria. There is a tendency for the young generations with higher education to emigrate to foreign countries more and more, but this is a serious loss to the two countries. Bulgaria and Romania are required to create jobs for the youth as many as possible and build societies full of vitality

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[1] According to news at the end of October 2005, Mr. Emil Kyulev was assassinated in Sofia on October 26, 2005. He was the biggest shareholder of DZI Financial group (A financial group which controls an insurance company, a lease company, etc.) and DZI Bank. The police views that he was involved in rivalry over territory. It was reported that already 15 persons were killed in that year with similar affairs (AP, October 26, 2005). *Asahi Shimbun* reports, "In Bulgaria in the past 5 years until 2005, 150 persons were killed by cases of murder in which mafias were involved. Mafias' activities have almost no fetters" (*Asahi Shimbun*, January 4, 2007)

[2] The Association Treaty includes four safeguard clauses. Other than the postponement clause, there are the general economic safeguard, the specific internal market safeguard, and the Justice and Home Affairs safeguard. Dragan (2006), p.5.