



POLICY NOTE OF WORKING PAPER 5.27

HAS ENP CHANGED THE INSTITUTIONAL, SOCIAL AND ECONOMIC PERFORMANCE OF EU NEIGHBOURING COUNTRIES?

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OBJECTIVE

One of the objectives of the European Neighbourhood Policy (ENP) is to promote political and institutional changes towards democratic governance and market liberalisation, a process that at the same time can be understood as a tool for economic development and convergence in neighbouring countries.

The objective of this paper is to analyse the macroeconomic, social and institutional impact of the ENP in a comparative and multidimensional perspective. With this aim, we first elaborate a composite index (Institutional, Social & Economic Performance Index – ISEPI) that combines data related to different economic, social and institutional factors. Second, we analyse regional differences in the evolution of this index in order to provide an assessment of the impact of the ENP on the different dimensions, but also to shed light on how the great recession has limited the impact of recent reforms. Finally we analyse if a convergence process has happened and if ENP plans have had a significant role.

SCIENTIFIC METHODS

The research relies on the construction of a multidimensional index combining information from more than 50 variables related to different hard and soft indicators. In particular, the ISEPI index built combines seven dimensions: macroeconomic environment, costs and prices, productivity and human capital, technological and innovative capacity, business-friendly environment, quality of life and labour market conditions and, finally, market potential. This index is built from the combination of the seven partial indicators that express the relative standardised position of every country after combining the variability of all input variables.

The index is calculated for 75 countries from 1995 to 2011 combining data for 51 variables obtained from several sources: World Bank, OECD, IMF, The Fraser Institute, Transparency International and IMD, among others. The countries considered included the most competitive economies according to the World Economic Global Competitiveness Report, the core European Union member states,

emerging economies and the EU neighbouring countries. These countries are also grouped in different regions according to their level of development and geographical situation.

In order to analyse if there exists a convergence process, we start with an unconditional β -convergence analysis running the following a la Barro and Sala-i-Martin (2003) regression:

$$g_t = \alpha + \beta I_{0,t} + \epsilon_t$$

where g denotes the growth rate between 2005 and 2011 of the considered index, I_0 represents its initial value and ϵ_i is an error term capturing common transitional shocks for all countries. The parameter β captures the speed of convergence into a unique steady-state which is assumed to be common to all countries involved in the analysis.

Also, in order to evaluate if convergence to a country-specific steady-state is observed in the considered period, we have run the following conditional β -convergence regression for the ISEPI and the different sub-indexes:

$$g_{it} = I_{0,it}\beta + X_{0,it}\gamma + Z_i + T_t + \epsilon_{it}$$

where g_{it} represents the annual growth rate, $I_{0,it}$ the initial values of each index, $X_{0,it}$ is a matrix with the variables conditioning the convergence process (including two dummy variables that capture whether the ENP has been driven by a plan or a contract), Z_i and T_t denote, respectively country and time specific fixed effects and, last, ϵ_{it} is a random error term.

POLICY VALUE-ADDED

As highlighted by Wesselink and Boschma (2012), after the fifth enlargement round of the European Union (EU) in 2004 its external borders shifted drastically. Suddenly a range of poorer, economically and politically less stable and less democratic countries bordered the EU. In response to these changing circumstances the need was felt to create a unified policy towards the countries bordering the EU. The goal of this new unified policy would be to create a ring of friendly, stable and prosperous countries around the European Union in order to guarantee stability along the outer borders of the EU. The new policy would not offer accession perspective for these countries, as had been done before in order to drive reform in neighbouring countries. However, the policy would promote close political cooperation, close economic integration and ultimately access to the unified market, as a reward for convergence towards the EU 'Acquis' on economic regulations and progress in the areas of border security, prevention of illegal migration, an improved human rights record and expanded efforts towards democracy.

Although the core focus of the ENP is on trade and economic reforms, migration policies, institutional reform and collaboration in research and higher education are

also part of the ENP, and all these elements are meant to contribute to the ultimate goal of creating a ring of stable, friendly and prosperous countries around the EU (Com 393 final, 2003). The bulk of the ENP is bilateral. The ENP and the EU-Russia strategic partnership cover 17 countries. Apart of Russia, the ENP countries fall into two regional groups: The ENP-East countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine) and the ENP-South countries (Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, the occupied Palestinian territory, Syria and Tunisia). The ENP is a differentiated policy in which each country is supported to reform in its own speed, and with its own priorities. Based on specific country reports, action plans were negotiated that describe key priority areas for policy reforms. Up to now, the EU does not yet have action plans for four of the ENC: Libya, Syria, Belarus and Algeria. In the first three countries the main reason is that a basic level of democracy and human rights is required before incorporation in the ENP can take place. Algeria and the EU are still in negotiations over the ratification of an action plan.

The evidence on the impact of the ENP on economic and institutional is scarce. Previous research produced within the SEARCH project has found that the speed of the process of convergence of institutional quality towards European norms and values is still slow, although some progresses have been registered. In fact, according to Ascani et al. (2013), the results of the ENP on the eve of its tenth anniversary are much less impressive and the initial high hopes for a comprehensive and systematic legislative and regulatory alignment have not been realized. Institutional, social and cultural factors are central elements to consider when analysing social and economic dynamics in ENC. These results are mainly based on three particular analyses. First, Bartlett et al. (2013) analyse the link between economic growth and institutional reform in the ENC. Their results show that the ENP countries have a weaker institutional convergence to the EU than candidate countries. For them, the main reason is that the EU has not yet played an important role as a “transformative power”, shaping faster institutional convergence and there is a danger that the reform processes will either stagnate or “run out of steam” if the EU does not take a more decisive role in the process. Second, Hlepas (2013) have analysed whether or not institutional quality has converged across countries and the influence of this process on ENC’s competitiveness. The obtained results are in line with the ones obtained by Bartlett et al. (2013) suggesting that the impacts of the ENP have been relatively modest. Last, Revilla-Diez et al (2013) argue that there are several reasons why the ENP post-communist economies lag behind as compared to the high performing Asian countries that outstrip competitors in terms of economic growth. The most relevant one seems to be that post-socialist states did not manage to effectively change the institutions of the old regime for the new efficient ones. Moreover, even the minor institutional changes incorporated failed to work due to the lost faith in the state and the absence of fit with the existing informal institutional environment.

The paper allow to compare the economic, social and institutional situation (and evolution) of 75 very different countries associated to several different regions in the world, and specifically the EU, ENC-south, ENC-east countries. The paper gives information for seven different dimensions and also for the overall index.

The obtained results show that:

- (a) there are significant differences among countries in the ISEPI index;
- (b) the European Union neighbouring countries (ENC) are at the bottom positions of the figure;
- (c) there are some differences between those countries located in the south of European Union and those located in the east;
- (d) between 1995 and 2011, only in case of developed and European Union countries an improvement in the ISEPI index is observed;
- (e) a convergence process to a unique steady-state is not observed in the global ISEPI index;
- (f) a conditional convergence process have occurred during de period. At dimension level, only in the case of Macroeconomic Environment and Quality of life and labour market conditions sub-indexes the convergence speed has been improved.

The obtained results show that ENP has had different effects according to the considered dimensions and that the evolution of neighbouring countries is quite heterogeneous taking into account their recent institutional, social and economic performance.

From a policy perspective, these results reinforce the validity of the bilateral action plans that have characterized ENP recognising the different starting point and particular characteristics of each neighbouring country.

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