LAPPEENRANTA UNIVERSITY OF TECHNOLOGY
Northern Dimension Research Centre
Publication 40

Tuuli Mirola

EUROPEAN UNION EASTERN ENLARGEMENT
- EXPECTATIONS AND EXPERIENCES OF DOING BUSINESS IN THE NEW MEMBER STATES

Lappeenranta University of Technology
Northern Dimension Research Centre
P.O.Box 20, FIN-53851 Lappeenranta, Finland
Telephone: +358-5-621 11
Telefax: +358-5-621 2644
URL: www.lut.fi/nordi

Lappeenranta 2007

ISBN 978-952-214-389-1 (paperback)
ISBN 978-952-214-390-7 (PDF)
ISSN 1459-6679

European Union Eastern Enlargement
- Expectations and Experiences of Doing Business in the New Member States

Tuuli Mirola

Contents

List of tables

List of figures

Foreword

The Northern Dimension Research Centre (NORDI) is a research institute run by Lappeenranta University of Technology (LUT). NORDI was established in the spring of 2003 in order to co-ordinate research into Russia.

NORDI's mission is to conduct research into Russia and issues related to Russia's relations with the EU with the aim of providing up-to-date information on different fields of technology and economics. NORDI's core research areas are Russian business and economy, energy and environment, the forest cluster, the ICT sector, as well as logistics and transport infrastructure. The most outstanding characteristic of NORDI's research activities is the way in which it integrates technology and economics.

LUT has a long tradition in conducting research and educating students in the field of communist and post-communist economies. From the point of view of these studies, LUT is ideally located in the Eastern part of Finland near the border between EU and Russia.

This book deals with various aspects of European Union enlargement effects faced by the companies from EU15 and especially from Finland when doing business in the ten transitional economies now belonging to European Union. In this context, qualitative as well as quantitative indicators have been used.

Lappeenranta, May 2007

D.Sc. Tuuli Mirola
Researcher
Northern Dimension Research Centre
Lappeenranta University of Technology

1 Introduction

1.1 Background

In the aftermath of the Second World War the Old Continent was ideologically divided in two parts. In the west democratic societies combined with market economy were competing against the centrally planned system of communist totalitarianism. The latter system collapsed in the last decade of the 20th century ending the era of the Cold War.

The post-communist transformation in the Eastern part of Europe gave new impetus of pan-European economic integration, which had advanced in the West already in the Cold War period. The customs union called European Economic Community (EEC) which comprised in its original form in the late 1950s only six countries had 15 member states in the mid-1990s. The customs union took a form of common market and changed her name To European Union (EU).

Quite obviously, EU-membership became and attractive option to many transitional economies in the early period of post communism, during which the Eastern economic integration edifice Council of Mutual Economic Assistance (CMEA) was dismantled. This trading block comprised the former Soviet Union with her East European satellites (Poland, The former Czechoslovakia, Hungary, Bulgaria, Romania, and East Germany (GDR)). After the collapse of the Berlin Wall, East Germany merged with West Germany.

The former Federation of Yugoslavia was never a member of CMEA. Former states of communist Yugoslavian Federation look for EU-membership, which was given to Slovenia in the framework of EU's Eastern enlargement in 2004. This enlargement included three former Soviet republics (Estonia, Latvia and Lithuania), plus Poland, Hungary, and the former Czechoslovakia (now the Check Republic and Slovakia), all "Eastern block" countries also called "Soviet Satellites". Also Romania and Bulgaria were formerly CMEA-countries, but these two post communist countries were not allowed to enter the EU in 2004. The delay in Bulgarian and Romanian case was caused by slow economic reform in both countries.

Thus, EU's expansion in the post-communist East is an extremely complicated process which is not completed yet with Bulgarian and Romanian membership of 2007. Croatia, a former Yugoslavian republic, is a likely EU-member in the near future. Serbia, Macedonia, Bosnia-Herzegovina, and Montenegro are real or potential candidates from former Yugoslavia. Ukraine, one of the 15 former Soviet republics has interest in joining EU. Therefore, EU's Eastern enlargement has still plenty of potential.

1.2 Focus of the study

Creating a single European home market of over 490 million people in the 27 member countries by removing the trade barriers between them has resulted in one of the largest regional markets in the western world, compared with the about 443 million in NAFTA (North American Free Trade Agreement) countries United States, Canada and Mexico as well as 127 million in Japan. Markets in China and India (1,321 million and 1,129 million, respectively) naturally, compete in totally different population levels.

The situation in the European Union today is unique. The accession of a large group of central and eastern European countries (CEECs) marked the ending of the division of the European continent in the aftermath of the Second World War. For the CEECs it also marked the end of a transition process to democracy and a market economy.

The group of new members in 2004 was larger and more heterogeneous than in any of the enlargements before, which required extreme adjustment both from those countries as well as from the union. The enlargement posed a major challenge: the number of countries, the area (increase of 34%) and population (increase of 105 million), the wealth of different histories and cultures. Latest enlargement took place in 2007 as Romania and Bulgaria joined the union thus increasing the EU population by almost 30 million. Today the queue of potential applicants is more challenging than ever before.

This study focuses on the effects of the European Union enlargements in the Central and Eastern Europe in the 21st century, i.e. the memberships of Estonia, Latvia, Lithuania, Poland, Hungary, Czech Republic, Slovakia, Slovenia, Romania and Bulgaria (NMS-10). Cyprus and Malta have been omitted from the research since they do not belong to the group of transitional economies (TEs) like the other 10 new members and have therefore not faced the same changes and challenges. In addition their economic influence on the Union remains minor.

Profound background information on the 10 new member states and business opportunities in them can be found in numerous studies.[1] The potential consequences of these countries joining the union had been studied ever increasingly since the start of the transition and reform process in Eastern Europe and especially after the beginning of the accession negotiations for the 2004 enlargement. Also research data on the realized consequences has

[1] List of previous research on the topic conducted in Lappeenranta University of Technology is presented in Annex I in this report.

already been published since the 2004 enlargement and preliminary data on the 2007 enlargement will probably be available soon.

Studies have been conducted both the EU15 countries and in the new member countries (NMS-10). Their points of view have varied from macroeconomic consequences at national level to microeconomic implications at company level. The focus of research in the EU15 has varied from the effects on the business activities at home and on their national market to their business activities in the NMS-10 and on their markets. Likewise, the research in the NMS - 10has been conducted from the point of view of their own countries and the Union.

The aim of the study is to take an overview on the great number of effects of the enlargement on the business environment in the 10 new member states of the European Union. The focus is primarily on the business and companies from the old EU15 countries, mainly from Finland, operating in the area of the NMS-10, not on the local companies. Finnish data is used whenever available and reference is made to other EU15 country data for comparison.

Chapter 2 summarises the likely effects of the European Union eastern enlargement from the point of view of business community's expectations beforehand. General attitudes both in the new member countries as well as in the old union countries towards the enlargement are discussed. Business opportunities in terms of untapped trade potential as well as fears of possible threats arising from the enlargement, such as increasing competition, are analysed. Overview of the sectoral differences regarding the prior expectations of Finnish industry is also presented.

Analysis of how interesting the new member countries and their markets were estimated to be from the point of view Finnish companies is presented in Chapter 3. The interest is analysed by sector and by company size.

Chapter 4 discusses the realised situation in the light of the previous expectations. First, a brief overview of the business environment in the new member countries in general is presented. Then issues regarding enlargement effects on costs, competition, and labour are discussed in detail. Trade effects are also presented briefly. Issues of the crime and fraud scene in the new member countries are brought up at the end of Chapter 4.

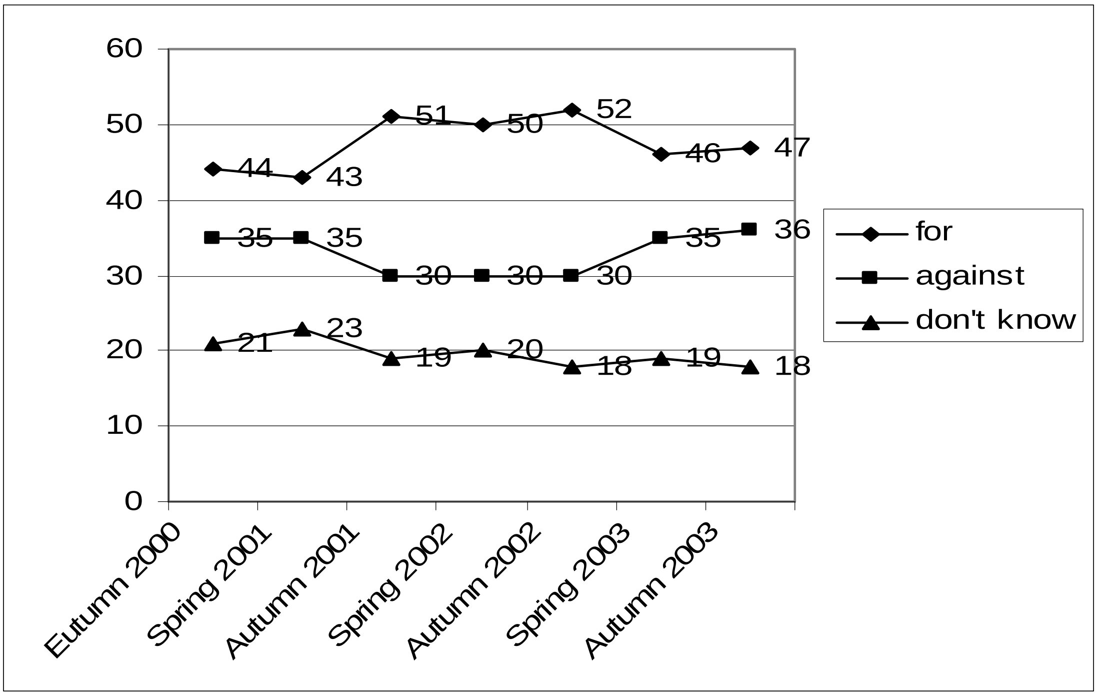
Chapter 5 discusses the companies' strategic responses in the enlargement European Union market as well as the effects of the enlargement on their investments in the new member countries. Chapter 6 summarizes.

2 Expectations prior to the European Union eastern enlargement

2.1 General attitudes

The enlargement process was not welcome unanimously. In fact, it was given a lukewarm reception by both old and aspirant member states (Van der Putten 2002). The Eurobarometer (2002b) showed a similar response in the existing member states, with only a small majority (51%) in favour of enlargement and 30% against. Support for the enlargement declined since autumn 2002. In spring 2003 it was 46% while 35% said they were against it. (Eurobarometer 2003a)

Figure 1. Support for enlargement in EU15.

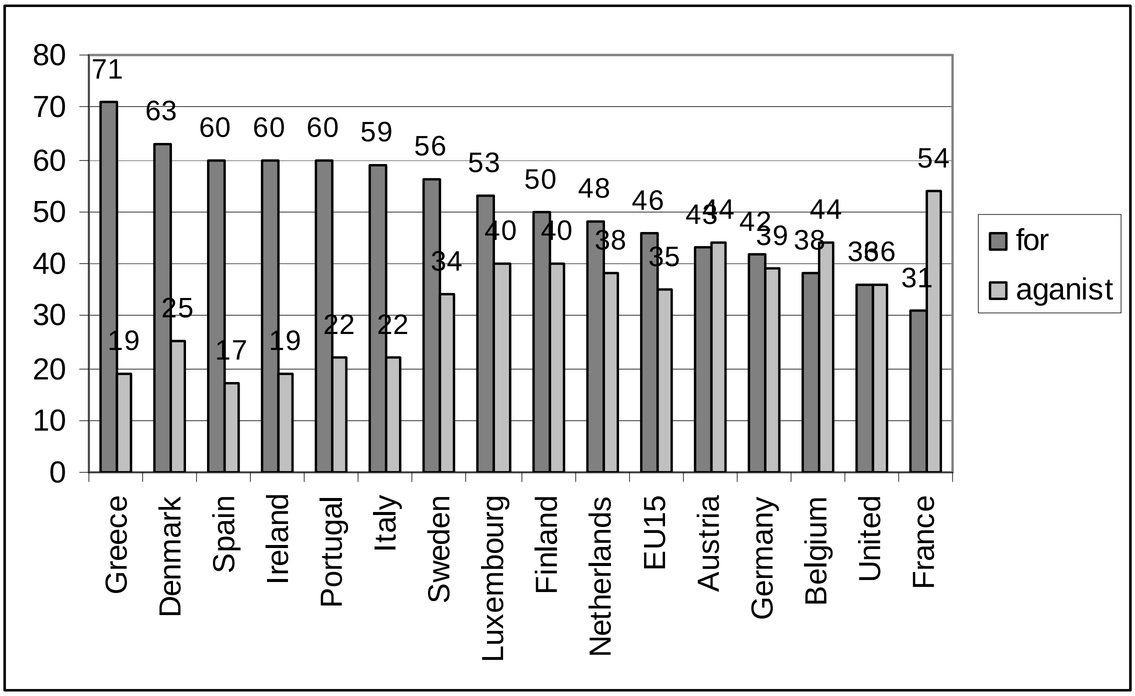


Source: Eurobarometer (2004b)

A year before the accession date, support for enlargement[2] was favoured by the majority of people in eleven of the fifteen member states (see Figure 2). The exceptions were Austria (43% of people in favour of enlargement), Germany (42%), Belgium (38%), France (31%) and the United Kingdom (36%). The most strongly in favour of enlargement were the Greeks (71%), followed by the Danes (63%), the Spanish, the Irish and the Portuguese (all 60%).

[2] Note that the question refers to an enlargement in general, not specifically to the 2004 enlargement. The question asked in the Eurobarometer poll was: “Please tell me whether you are for or against it: the enlargement of the European Union to include new countries.”

Figure 2. Support for enlargement March-April 2003.



Source: Eurobarometer (2003a)

The Eurobarometer survey (2003a) shows that people who felt they knew a great deal about the European Union (58%) were more likely to be in favour of the enlargement than those who felt they did not know very much (36%). However, the number of those against did not vary greatly in these groups. The difference in the support rate can therefore be an indication that those who thought they did not know very much about the EU were far more likely not to have an opinion about enlargement than those who thought they knew a great deal (26% and 12% respectively). (Eurobarometer 2003a, p. 20)

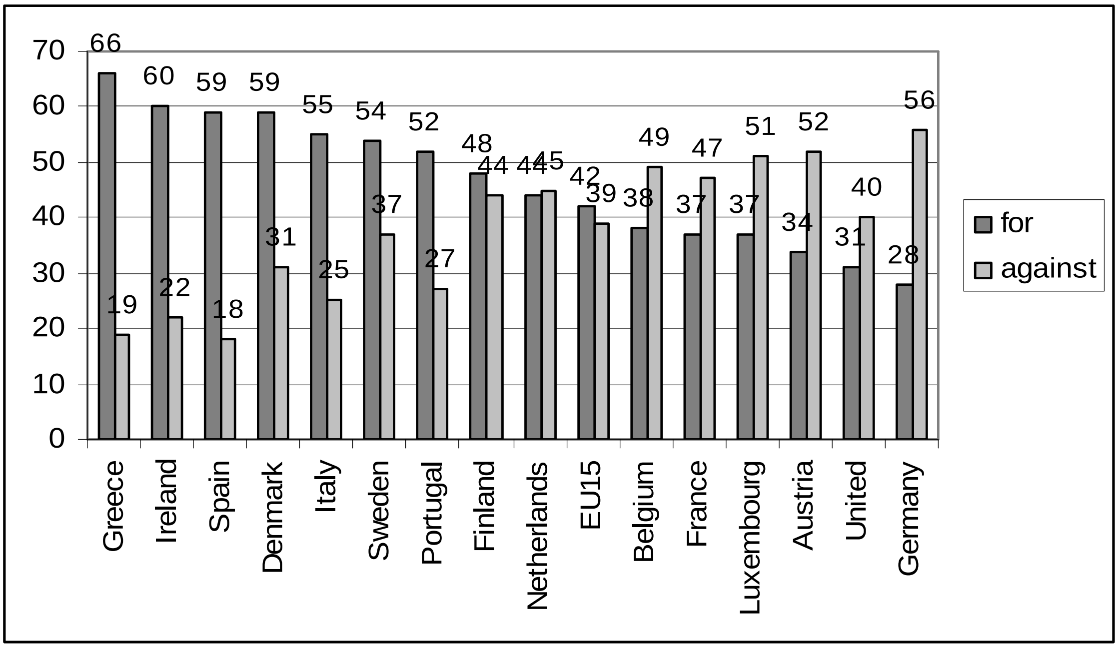
Table 1. Relationship between support for enlargement and perceived knowledge of the EU.

Enlargement:	Perceived level of knowledge		
	Low	Average	High
For	36	52	58
Against	37	34	30
Don’t know	26	14	12
Total	99	100	100

Source: Eurobarometer (2003a)

When the largest enlargement in the European Union’s history was only a couple of months ahead, a relative majority of the EU15 citizens claimed that they supported it: 42% favoured the membership of the ten new countries, while 39% opposed it.[3] The Greeks (66%) and the Irish (60%) had the highest number of respondents in favour of the 2004 enlargement, whereas the Germans (28%) and the British (31%) were the least enthusiastic. (Eurobarometer 2004a)

Figure 3. Support for 2004 enlargement in February-March 2004.



Source: Eurobarometer (2004a)

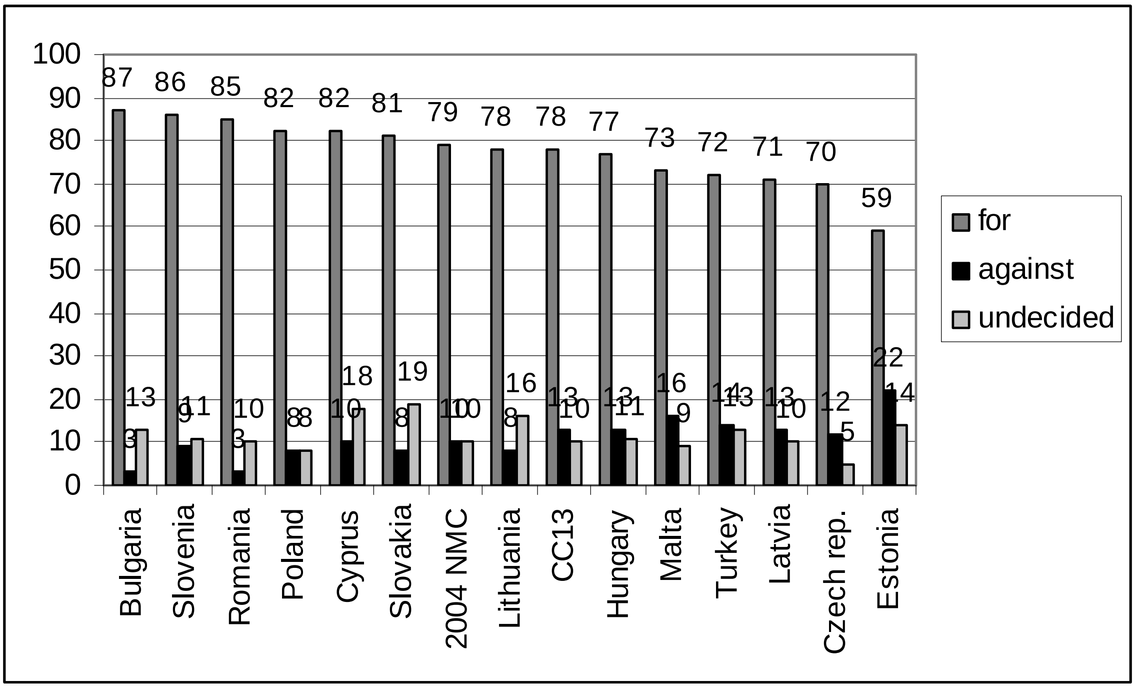
It should be noted that at the same time attitudes towards further enlargement of the EU to include other countries in future years were more negative than towards the 2004 enlargement. Majority (43%) of EU15 citizens opposed the idea, 37% supported it and 20% expressed no opinion in its regard. (Eurobarometer 2004a) In autumn 2006 both the support (46%) and opposition (42%) had increased, while the share of respondents having no opinion had decreased to 12% (Eurobarometer 2006).

The aspirant members had their hesitations, too. In 2001 only 59% of their population were in favour of EU membership, ranging from 33% in Estonia and Latvia to 80% in Romania (Eurobarometer 2002a). However, as the accession date came closer, the support became stronger. In 2003 June-July 79% of the respondents in the 2004 accession countries were in favour of enlargement. The respective figure for the CC13 (2004 accession countries and

[3] Contrary to the previous Eurobarometers, the new formulation of the question used in Eurobarometer 61 was: “Please tell me whether you are for or against it: the enlargement of the European Union to include ten new countries this May.” Comparisons with previous accession questions should therefore be treated with caution.

Romania, Bulgaria and Turkey) was 78%. The highest support levels were found in Bulgaria and Slovenia (87% and 86%, respectively). The opponents were strongest in Estonia (22%). (Eurobarometer 2003b)

Figure 4. Support for enlargement in June-July 2003.



Source: Eurobarometer (2003b)

The above results refer to the whole population, but as a break down of the data by the respondent's occupation (see Table 2) and education shows, enlargement is supported principally by managers and high qualified respondents.

Table 2. Support for enlargement by occupation in CC13.

	Self employed	Managers	Other white collars	Manual workers	House persons	Un-employed	Retired
For	80	84	79	80	69	79	75
Against	12	11	13	9	10	8	9
Don't know	9	4	8	11	22	13	17
Total	101	99	100	100	101	100	101

Source: Eurobarometer (2003b, annex, table 1.9B)

2.2 Business opportunities

The actual and potential volume of trade between the EU and the candidate and/or new member countries has been studied increasingly since the start of the transition and reform process in Eastern Europe. The Baldwin (1994) study is one of the most widely cited and used as a reference for example by Nilsson (2000). Nilsson uses the gravity model to study whether there was unused trade potential between the EU and the candidates (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia and Slovakia of the 2004 accession countries as well as Bulgaria and Romania). His projections of potential trade in 1995-1996 indicated that the differences between actual and potential trade between the CEECs and the EU had been reduced compared to the study of Baldwin (1994) on data for 1989. According to Nilsson's data, the ratio of the EU's potential to actual exports to the candidate countries was 1.1, indicating that the EU's actual exports were slightly lower than estimated potential exports. However, his results suggested that several EU countries, including Finland, exported more to the candidate countries than the gravity model predicted. The potential to actual export ratios from Finland (from the EU15) to the candidates were as follows: Bulgaria 0.7 (0.9), the Czech Republic 0.8 (1.8), Estonia 0.3 (0.4), Hungary 0.4 (0.7), Latvia 0.1 (0.5), Lithuania 0.3 (0.8), Poland 0.6 (1.0), Romania 3.3 (0.9), Slovakia 0.6 (1.2), Slovenia 1.3 (0.9), and Cyprus 0.7 (0.4). Nilsson (2000, p. 826) concludes that the high degree of trade integration with the EU indicates that all the candidate countries are competitive in the EU market.

Lindström (2003) found that Finnish export to the Baltic Sea region had untapped potential only in its Polish and Russian trade. Calculations by Widgrén (2006) support the findings for Poland. Also e.g. Ferragina et al. (2005) agree that the trade potential between EU and the CEECs was quite close to being exploited already in 2002. The ratio was between 1 and 2.5. The projected actual to potential ratio of imports systematically exceeded that of exports. It indicates that there was wider scope for an increase in imports than in exports, and might also suggest that the CEECs within the Europe agreement had not fully benefited of a total and preferential opening for their exports to the EU.

The opportunities expected from the widening of the European Union in 2004 were examined from the point of view of Finnish exporters by a survey conducted about a half a year before the 2004 enlargement (Mirola 2006). Most respondents in the study referred to the expanding markets as the greatest opportunity expected. Easier and increasing export opportunities as well as investment and purchase related opportunities were also brought up.

A growing market was also seen as the most important factor strengthening the business potential in the new member countries in a study by Alho et al. (2004). The potential for increasing investments is evident also in the results of Alho et al. (2004) who report that about 30% of the industrial companies in their study indicated that they will expand their own production activities in the new member countries and rather less than 30% relocate some of their activities to the new accession countries, industrial production being the primary activity to be relocated (20%), followed by customer services and subcontracting (7%). It is evident that the low cost level in the new member countries is attractive for the Finnish companies. According to Alho et al. (2004, p. 66), exports and FDI support each other.

The opportunities were described at a very general level and no specific issues were presented by the participants of the Finnish study (Mirola 2006, p. 171). All the responses are summarized in Table 3.

Table 3. Opportunities expected from the widening of the Union in 2004.

Markets and exports	Other opportunities
Expanding markets	"More opportunities"
More exports to the Baltic states	Economic development of new members
Easier trade in the Baltic states	Easier raw material purchases
Lighter export formalities	Investments in new members
Opening up of borders makes movement of goods easier	Due to environmental legislation cost level in the new countries will also rise
Growing turnover	Effects of the new members looked forward to
Simplified import trade increases opportunities	EU legislation in force also in the new countries
No fears but possibilities offered by larger markets	Increasing building in new member countries due to investments
Growth in general	Employees from Estonia
	Generally more clear economic policy
	Cooperation

Source: Mirola (2006)

When estimating the eastern enlargement effects on Finland and other EU countries in general, one should bear in mind that geographical location has its effects, too, especially on sensitive sectors. From the Finnish point of view, the Baltic States, and possibly also Poland, are more favourable and more easily controllable in terms of exports, distribution and establishment costs than the more remote new accession countries. (Mirola 2006, p. 168)

2.3 Threats

Prior to the 2004 enlargement, particularly in the manufacturing industry, it was feared that the enlargement would accelerate the process of globalisation and result in a relocation of labour intensive industries to the new member states. This could increase unemployment in the EU, in particular for unskilled workers and an increase in income inequality. (Van der Putten 2002)

Most companies who expected negative effects or threats emerging form the accession of the 2004 new member countries were concerned about the increasing competition. Companies feared the low cost level, especially the low wages, in the new member countries to have an unfavourable competition effect on them. However, as Alho et al. (2004, p. 40) remind, the essential question is whether the new member countries will preserve this cost advantage and for how long. Alho et al. (2004) have calculated three different convergence scenarios. The most likely scenario is the one with 5% annual economic growth. Thus the wage convergence will take a relatively long time, approximately 30 years.[4]

At the same time, the difference in the standard of living caused exporters to fear that the purchasing power in the new members would not be high enough for their products to be able to enter the new market profitably.

On the whole, the fears appear to be rather stereotypical, and for the most part the very same issues have been mentioned now in the context of the EU membership as before since the transitional process in Eastern Europe began. Lower production costs and thus lower prices worry many companies, but also more marginal phenomena such as plagiarism and criminality were brought up.

Summary of the threats expected by Finnish export companies are presented in Table 4.

[4] For more detailed analysis on labour costs, see Chapter 4.4 Costs.

Table 4. Threats expected from the widening of the Union in 2004.

Competition, costs , prices	Other threats
Unhealthy competition	Future seems gloomy
Increasing price competition	Increasing subsidies for new members
Cheap Estonian products	Decreasing profitability
Cheap production “wins”	Crimes
Increasing low cost production	Low labour costs in new members
Cheap labour	“We will disappear in the bowels of a great power”
Baltic countries activate and get competitiveness from their low cost level	“Estonians rushing to Finland”
Competitors from new members come to Finland	Estonian membership
Union costs will increase	Taxation
Expensive!	Stability will be disturbed
Money from the old members is not enough for the development of the new members	Purchasing power in the new members
Price disturbances	Plagiarism
	Possibilities to continue industrial production in general in Finland become narrower
	Too many negative effects

Source: Mirola (2006)

”It can be concluded that the expectations concerning the enlargement in 2004 were bipolar: on one hand, there was the fear of increasing (price) competition, and on the other, the opportunities of new European markets” (Mirola 2006, p. 172).

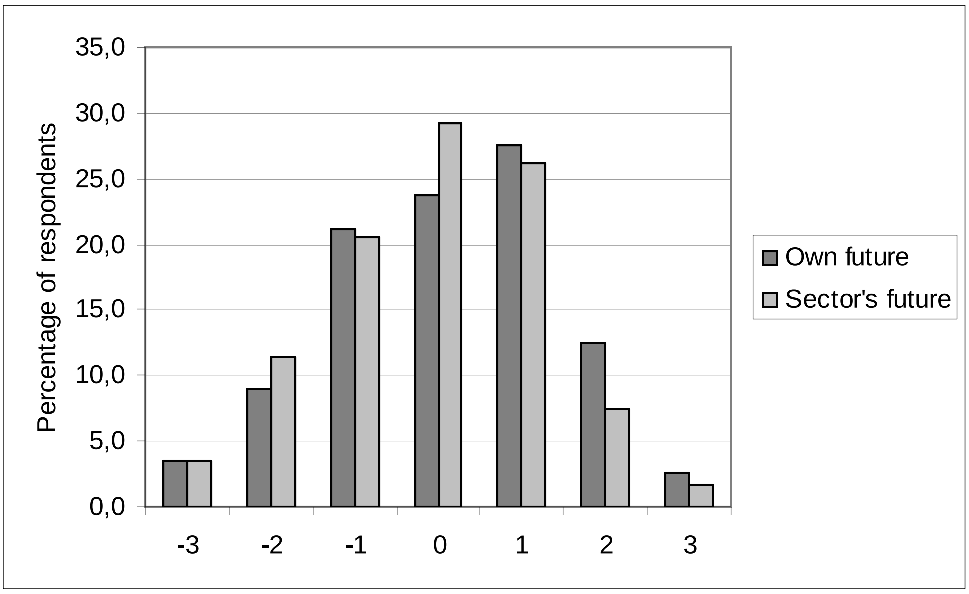
2.4 Sectoral expectations

Before the enlargements, studies were conducted on which sectors were expected to benefit and which to lose due to the eastern enlargement. (E.g. in Finland by Alho et al. 2001a &b and Pirilä 2002) In EU terms, opportunities for commodity trade from EU15 were concentrated in certain key areas: Mechanical machinery, electrical machinery, vehicles, plastic and paper products. In terms of service trade the key areas were regarded to be recycling and environmental services, financial services, equipment rental, computer services and business services. For services, potentially large markets were especially prominent for financial services. (Zuleeg 2002)

In a Finnish study (Mirola 2006) export companies rated their expectations concerning the possibilities and threats associated with the enlargement of the union in 2004. A distinction was again made between the companies' own expectations and those of their sector as a whole.

The companies' own expectations were positive slightly more frequently (43%) than the expectations of their sector (35%). Companies reported neutral expectations for their own part in 24% of cases and for their sector's part in 29%. On a seven-point scale of "-3 = threats" to "3= opportunities", the mean of the companies' own expectations was 0.11 and their sectors' -0.07. Interestingly, the Finnish exporters thus expected the threats to exceed the opportunities more frequently for their sector but reported positive expectations to exceed the negative for their own company as depicted in Figure 5.

Figure 5. Expectations of 2004 enlargement.

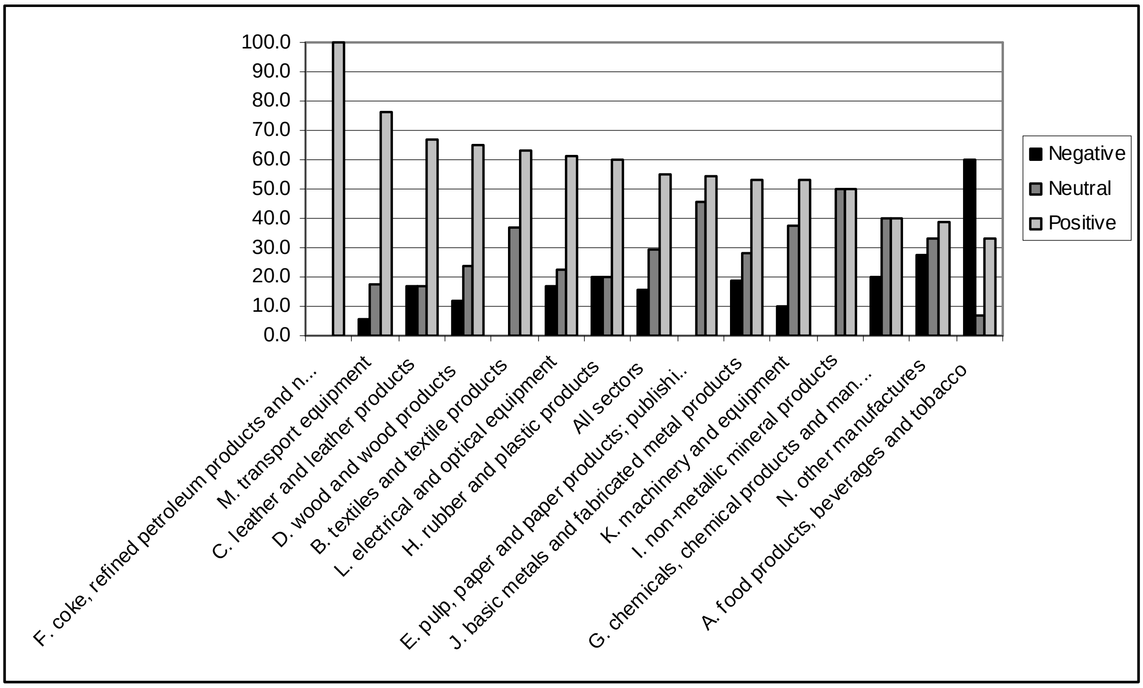


Note: Assessed by a scale of -3 threats to +3 opportunities.

About 19% of the companies reported that their own expectations were more positive than those of their sector, while the opposite was reported only by 7% of the respondents. The difference in the distribution of expectations is statistically significant.

When looking at the sectoral breakdown of the expectations the companies' own expectations were positive in 50% or more of the cases in 12 out of 15 sectors (see Figure 6). Only in the food, beverages and tobacco sector, chemical sector and other manufactures sectors the negative and neutral expectations were more frequent than the positive ones. The negative expectations were the most pronounced (60%) in the food, beverages and tobacco sector.

Figure 6. Companies' own expectations on enlargement. Percentage of respondents.

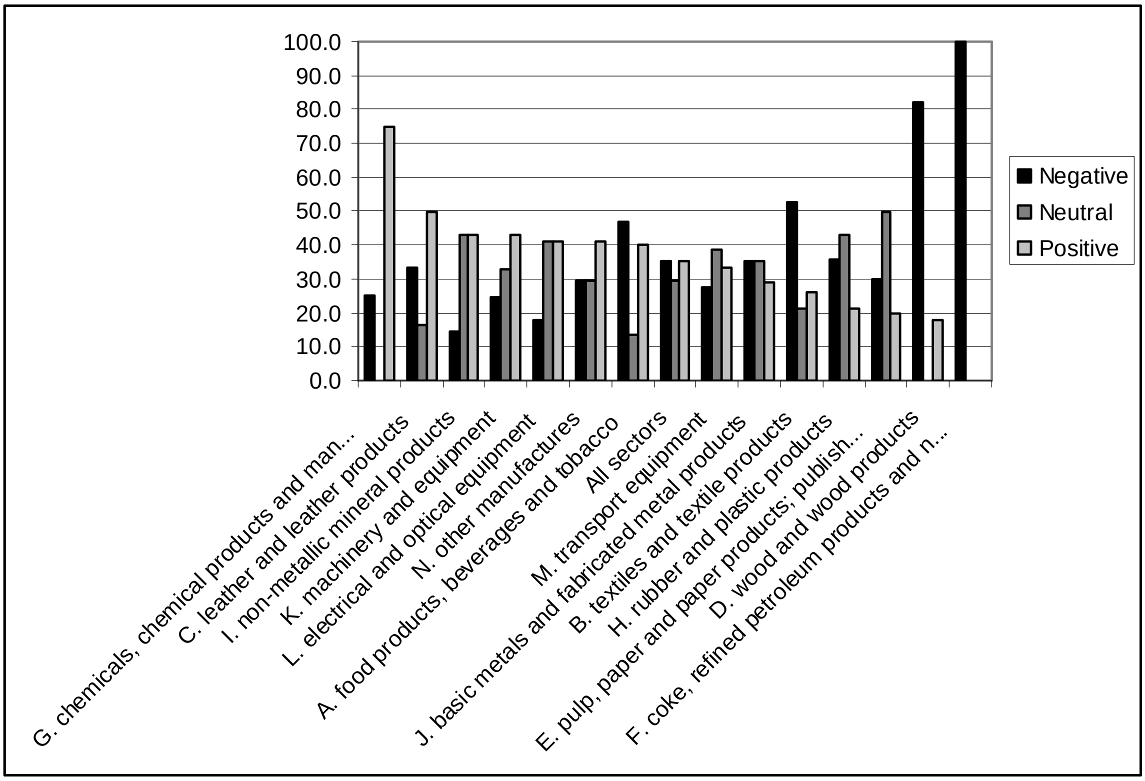


However, as stated before, the expectations concerning the sectors as whole (as opposed to individual companies), the expectations were more gloomy. The share of negative expectations remained under 20% only in non-metallic mineral products sector and electrical and optical equipment sector. Most frequent negative expectations were found in textile sector and wood/wood products sector (see Figure 7).

Interestingly, in the textiles and textile products sector, the share of companies expecting positive effects for themselves exceeds 60% and none expected negative effects. Yet, the respective shares for the whole sector ware only abort 26% positive and over 50% negative expectations. This sector has traditionally been one of the most protected and therefore the most sensitive sectors in Finland.[5] Acute fears have been expressed that the sector will relocate its production in lower cost economies. The sector is characterised to have been affected by moderate non-tariff trade barriers and high penetrations rates. In the sector price dispersion is high and substantial economies of scale can be reaped. (Kajaste, 1990, p.5)

[5] See analysisi on the sensitive sectors by Kajaste (1990)

Figure 7. Sectoral expectations on enlargement. Percentage of respondents.



Some interesting exceptions were found regarding the common trend of individual companies' expectations being positive more frequently than the expectations of entire sectors. The expectations of the chemical sector on the whole were positive in about 75% of cases while the respective figure for individual companies in that sector was positive only in 40% of cases. Also, in the food, beverages and tobacco sector the individual companies' expectations were negative more frequently (60%) that in the whole sector (under 50%). Especially wide difference of expectations was revealed in the wood/wood products sector where individual companies reported positive expectations in 60% of cases while the expectations for the whole sector were negative in 80% of cases.[6]

[6] Although the coke, refined petroleum products and nuclear fuel sector is presented in the Figures 6 and 7, it is not analyzed due to the fact that the sector was represented by a single company in the data.

3 Interest on new member countries

Finnish exports to the new member countries were not generally expected to decrease or discontinue due to their EU accession. Only a couple of export companies participating in the Finnish study (Mirola 2006) about 6 months before the enlargement took place reported such changes. Exports to Poland were expected to increase the most frequently. The importance of Poland as an export country was indicated also by the fact that Poland was reported among the five fastest growing export markets as measured by the average export growth rate in the past 2 years. Generally, increasing exports were expected by the majority of the respondents to all the new members[7] apart from Slovenia and the above-mentioned Malta and Cyprus, where an increase was expected by 46%, 12% and 25% of exporters, respectively. Table 5 summarises the expected changes by country.

Table 5. Expected changes in exports due to 2004 enlargement, percentage of respondents.

Country	Increase	No changes	Decrease	Discontinue
Poland (N= 115)	73.9	22.6	3.5	0
Latvia (N= 117)	66.7	29.1	3.4	0.9
Lithuania (N= 110)	62.7	30.9	5.5	0.9
Hungary (N= 80)	62.5	33.8	2.5	1.3
Czech Republic (N= 81)	61.7	37.0	0	1.2
Estonia (N= 171)	59.6	36.3	3.5	0.6
Slovakia (N= 65)	53.8	41.5	1.5	3.1
Slovenia (N= 52)	46.2	51.9	0	1.9
Cyprus (N= 32)	25.0	68.8	6.3	0
Malta (N= 24)	12.5	87.5	0	0

Note: Number of respondents and percentages refer to companies that already exported to the countries in question prior to 2004 or expected to start exports.

To examine how interesting the 2004 accession countries were as new export countries, the companies who did not export to them at the time of the survey were asked to assess each of the countries as potential export markets. As can be seen in Table 6 the Baltic States and Poland were rated interesting and likely export countries the most frequently. Export entry decisions concerning these countries had already been made by several companies.

[7] Similar results have been found by Alho et al. (2004): A significant share (55%) of companies operating the Baltic States or Poland intended to expand their exports in the new member countries.

Table 6. Interest as new export markets, percentage of respondents.

Country	New	Likely	Considered	No interest
Estonia (N=132)	14.4	31.8	21.2	32.6
Latvia (N= 156)	9.0	16.0	28.2	46.8
Poland (N= 166)	9.0	15.7	30.7	44.6
Lithuania (N= 160)	6.9	13.8	30.6	48.8
Hungary (N= 175)	4.0	12.0	24.0	60.0
Czech Republic (N= 179)	2.2	13.4	22.9	61.5
Slovakia (N= 186)	1.6	9.1	18.8	70.4
Slovenia (N= 190)	1.1	5.8	20.0	73.2
Malta (N= 200)	1.0	1.5	9.0	88.5
Cyprus (N= 195)	1.0	2.1	8.7	88.2

Note: Number of respondents and percentages refer to companies that had no exports to the countries in question prior to 2004. Percentages in the first column "New" refer to the companies who had already made export entry decision to the countries in question.

If a company had reported exports to at least one of the EU10 countries, it was more likely to be interested in starting exports to one or several of the other EU10 countries than companies with no previous exports to any of them.

3.1 Interest by sector

Sectoral examination of the 2004 accession countries as new export markets for Finnish companies[8] reveal that the interest of companies which did not already have exports to the 2004 accession countries varies across sectors (see Table 7).

[8] Based on survey data on Finnish export companies collected by the author in 2003.

Table 7. Interesting new export markets by sector.

Sector	Most interesting #1	#2	#3	Least interesting
A. food products, beverages and tobacco	Estonia	Poland	Latvia	Slovenia
B. textiles and textile products	Estonia	Latvia	Lithuania	Slovakia Slovenia
C. leather and leather products	Estonia	Poland	Latvia Lithuania	Slovakia Czech Republic
D. wood and wood products	Estonia	Poland	Czech Republic	Lithuania
E. pulp, paper and paper products; publishing and printing	Latvia Lithuania	Poland	Estonia	Slovakia Slovenia
F. coke, refined petroleum products and nuclear fuel	-	-	-	Slovakia Slovenia
G. chemicals, chemical products and man-made fibres	Estonia	Latvia Lithuania	Poland	Slovakia
H. rubber and plastic products	Estonia	Lithuania	Latvia	Slovenia
I. non-metallic mineral products	Lithuania	Latvia Czech Republic	Slovakia	Estonia
J. basic metals and fabricated metal products	Estonia	Lithuania	Latvia	Slovenia
K. machinery and equipment	Poland	Estonia	Latvia	Slovenia
L. electrical and optical equipment	Poland	Czech Republic	Estonia	Slovakia
M. transport equipment	Estonia	Latvia	Lithuania	Slovakia
N. other manufactures	Poland	Estonia	Latvia	Slovakia Slovenia

Note: Interest estimated by the smallest shares of companies reporting no interest.

Estonian export markets interested almost all of the responding companies in the food, beverages and tobacco sector, textile sector, leather and leather products sector, chemical sector and rubber and plastic products sector. Only single companies in these sectors indicated being not interested at all. The least interested in Estonian export markets were companies in pulp and paper sector (40%) as well as in wood and wood products sector (50%). In all other sectors over 50% on companies showed interest in Estonia as new export market.

Textile sector (77%) and chemical sector (80%) were the most interested in Latvia as new export market. This is in line with the fact that about 90% of companies in these sectors who already exported there expected the exports to increase also. However, even if all the companies in the electrical and optical equipment sector exporting to Latvia expected increase in their exports, the market was regarded interesting by only 25% of those not exporting these before 2004. The interest of other sectors on Latvian export markets varied form 27% to 69% of companies.

Lithuania is among the three most interesting new export markets in 8 out of 14 sectors. The sectoral interest in this market is very similar to the Latvian market with textile and chemical sector being the most interested. It is the least interesting market from the point of view of wood and wood product sector which generally did not expect their exports to increase there either.

Polish export market was regarded the most interesting new market by the machinery and equipment sector (72%) and the electrical and optical equipment sector (70%). In the other sectors the share of interested companies varied around 40% to 60%. Interestingly, export growth in this market was expected by over 70% of companies already operating in this market. The only exception was the rubber and plastic products sector where growth was expected by less than 40% of companies.

Interest in the Czech Republic as new export market was most frequently expressed in the machinery and equipment sector (58%). Other sectors' interest varied from 0% to 50%. No interest at all was shown in the leather and leather products sector. Export growth was expected most frequently by the wood and wood product sector (83%) and the transport equipment sector (80%).

Rubber and plastic products sector (40%) and the non-metallic mineral products sector (40%) were the most interested in the Slovakian export market. However, in these sectors, none of the companies already operating in the Slovakian market expected their exports there to grow. Export growth was expected most frequently by the transport sector (100%) and the machinery and equipment sector (80%), with the share of interested companies being only 15% in the transport sector and 47% in the machinery and equipment sector.

Slovenian market was generally not regarded to be very interesting as new export market. Most frequent interest was shown by the companies in the machinery and equipment sector (41%) and the chemical sector (40%). While all the companies in the transport equipment sector already exporting there expected their exports to grow, the market was regarded interesting as new export market by only 17% of companies.

3.2 Interest by company size

Finnish companies' interest in the new export markets varied slightly by the company size (see Table 8). Companies have been classified as small if they employ a maximum of 50 persons, medium-size with 50 to 100 persons and large with over 100 persons.

Table 8. Interesting new export markets by company size, % of companies.

Country	Number of employees	Export decision made	Likely export country	Exports considered	Not interesting as export country
Estonia	Max 50	13,6	45,5	16,7	24,2
	51-100	13,8	24,1	34,5	27,6
	Over 100	16,7	13,9	19,4	50,0
Latvia	Max 50	7,9	17,1	27,6	47,4
	51-100	8,8	17,6	29,4	44,1
	Over 100	11,1	13,3	28,9	46,7
Lithuania	Max 50	7,8	14,3	29,9	48,1
	51-100	2,9	17,1	34,3	45,7
	Over 100	8,5	10,6	29,8	51,1
Poland	Max 50	7,5	16,3	37,5	38,8
	51-100	5,7	8,6	31,4	54,3
	Over 100	14,0	20,0	20,0	46,0
Hungary	Max 50	2,4	13,3	28,9	55,4
	51-100	0	8,3	16,7	75,0
	Over 100	9,1	12,7	21,8	56,4
Czech Republic	Max 50	1,2	12,9	25,9	60,0
	51-100	0	8,1	21,6	70,3
	Over 100	5,4	17,9	19,6	57,1
Slovakia	Max 50	1,1	11,2	18,0	69,7
	51-100	0	8,1	18,9	73,0
	Over 100	3,4	6,8	20,3	69,5
Slovenia	Max 50	1,1	10,3	16,1	72,4
	51-100	0	2,7	18,9	78,4
	Over 100	1,5	1,5	26,2	70,8

Note: Percentages refer to companies that had no exports to the countries in question prior to 2004.

However, the correlation between company size and interest is statistically significant only in the case of Estonia. Estonian export market was considered interesting most frequently by the smallest companies with a maximum of 50 employees. Over 75% of the companies of this size had at least considered the Estonian market as new export market for their products.

However, the largest companies with over 100 employees had already made the export entry decision more frequently than their smaller counterparts.

Estonia is clearly the most interesting new export market from the small companies' point of view. This may partly be explained by the fact that the small companies are generally more prone to expand their activities to the nearest (both physically and culturally) foreign markets.

For the large companies with more than 100 employees, Poland was regarded as interesting new export market the most frequently. Over 50% of companies regarded it interesting and export entry decision had been made in 14% of the companies compared to the 17% in the case of Estonia.

While export entry decisions to Poland, Hungary and Czech Republic had been made more frequently by the large than the small companies, the small companies considered starting export there more frequently than the large ones. Again, the possible explanation of this phenomenon could be that the small companies tend to expand first to the nearest markets and only then to the more remote ones.

Slovakian and Slovenian export markets were the least interesting in each of the three categories by company size. Only 22-29% of all the companies reported interest towards these export markets. Nevertheless, the smallest companies regarded these as likely export markets more frequently than their larger counterparts.

Among the company size categories the medium-sized companies were the least interested in the Polish, Hungarian, Czechs, Slovakian and Slovenian export markets. Small and large companies both were interested in these markets as often.

4 Enlargement effects

The effects on EU15 companies can be studied from two points of view: whether the changes originate from the operations of the EU15 companies in the NMS-10 or the operations of the NMS companies in the EU15 markets. The interest of this paper in both these points of view focuses on the effects on the EU15 and especially Finnish companies' operations and economy on the whole (cases 1 and 4 in Table 9). In addition, the effects differ from each other based on whether they are of immediate and once-off nature or dynamic and cumulative (Alho et al. 2004, p. 2).

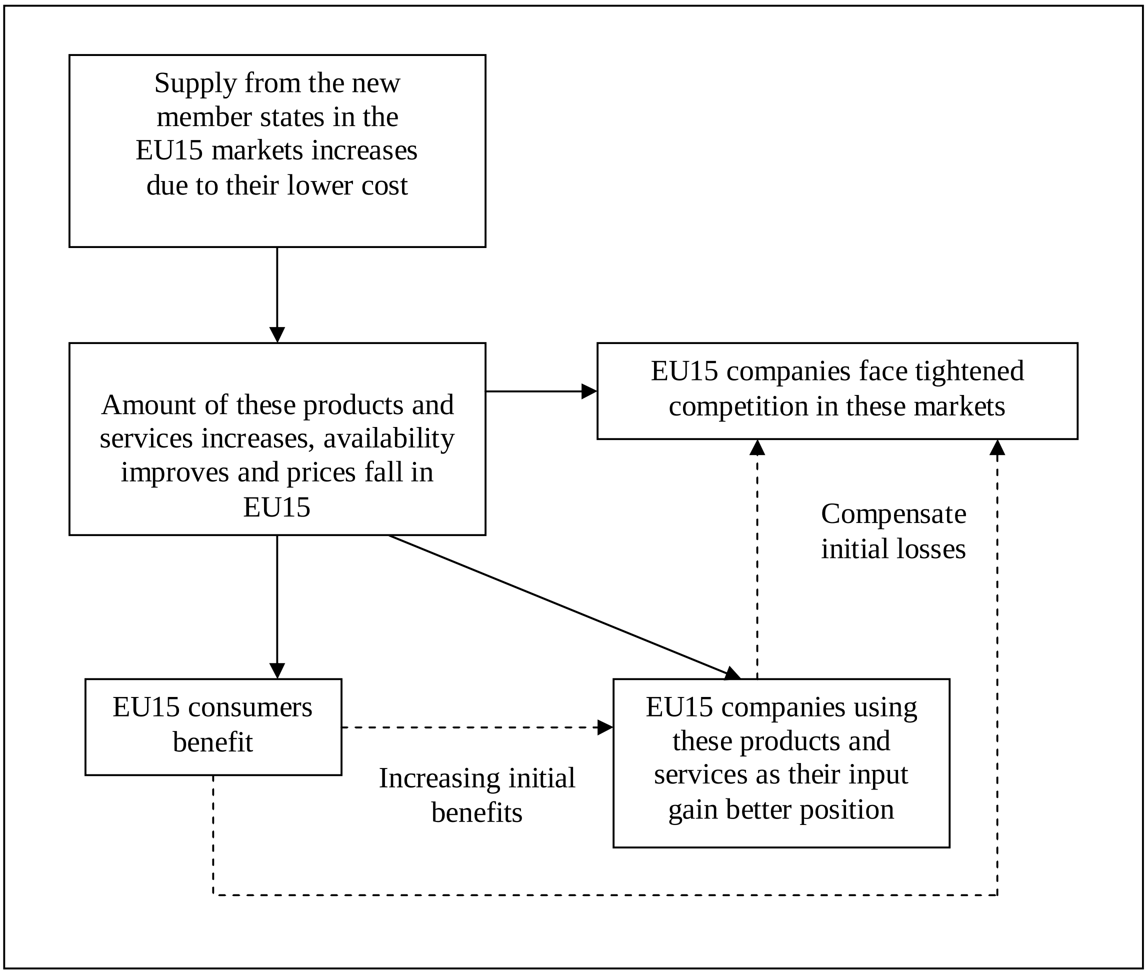
The enlargement effects on the EU25 market can be depicted as a 2by2 table. Table 9 separates effects both on the old EU15 market and new EU10 market as well as on companies from these markets.

Table 9. Enlargement effect on companies in EU15 markets and NMS-10 markets.

1. EU15 companies in their domestic markets	2. NMS-10 companies in the EU15 markets
3. NMS-10 companies in their domestic markets	4. EU15 companies in the NMS-10 markets

Figure 8 depicts the situation as the import competition on the EU15 markets increases due to the EU enlargement. Supply from the NMS-10 increases as their cost level is lower than in the EU15. This improves the availability of these goods and services and thus decreases their prices in the EU15. On one hand this creates competitive pressure but on the other hand those EU15 companies which use these products and services as their input benefit from it. Consumers naturally benefit from these effects also.

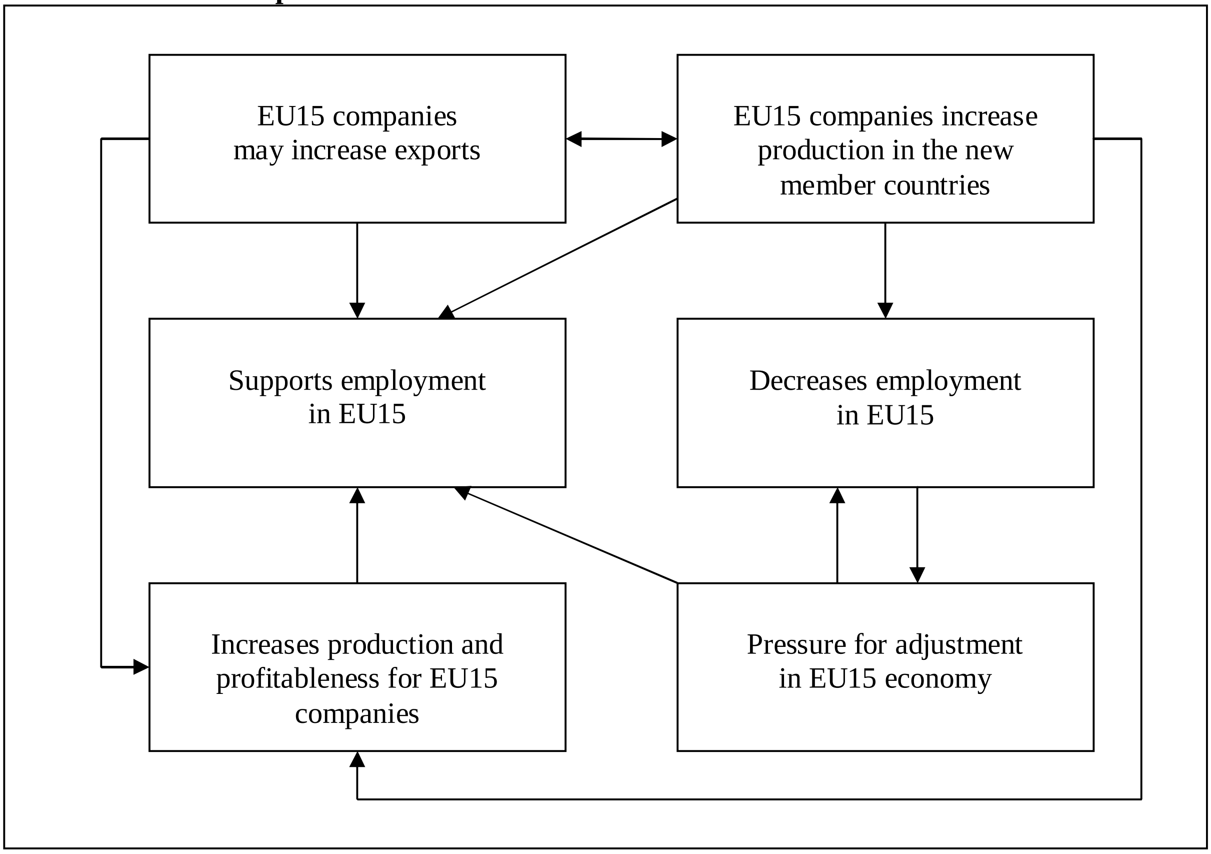
Figure 8. Enlargement effects on EU15 market.



Source: Adapted from Alho et al. (2004, p. 3)

Enlargement effects on EU15 companies in the new member states and their reflections in the EU15 market is depicted in Figure 9. Impacts on the EU15 markets result from the fact that EU15 companies can increase their activities in the new markets either so that they replace or complement their activities in their home countries. EU15 companies can offer their products and services in the new markets. Also subcontracting in the new markets is possible. In EU15 the pressure of adjustment increases if employment decreases due to the above mentioned actions. If this pressure is responded with flexible actions successfully, it will alleviate the negative effects of enlargement and strengthen the positive effects. These effects are discussed in more detail later in this report.

Figure 9. Enlargement effects on EU15 companies in the new member country markets and their domestic impact



Source: Adapted from Alho et al. (2004, p. 4)

4.1 Business environment in general

The EU accession was not expected to bring about any dramatic changes for industry in either old or new EU member states, because of the already existing high degree of integration in this area. The integration of European production and trade structures was already well advanced and continues at a gradual pace. However, in some sectors and areas adverse effects were expected. For example, the steel sector on several CEECs and SMEs in general as well as border region both in the old and new member states were estimated to be negatively affected. The dichotomy between modern, foreign-dominated industries (and companies) and domestically owned enterprises could even increase. (Havlik 2003)

In the EU15 states, acquis compliance of the CEECs was expected to further strengthen the creation of more complex and cost-optimising strategies that draw on complementary production factors, thus making it possible to enhance the competitiveness of European companies in the global context. (Havlik 2003, p. 26).

Havlik (2003, p. 27) reminds, that “one of the surprising tendencies of industrial and trade specialisation of the CEECs in the (economically) integrated European economy was the relatively rapid catching-up of some CEECs in technologically more sophisticated branches and also the relatively fast upward movement in intra-branch product quality” .

“The diversity of industrial and trade specialisation expresses itself in a two-pronged integration process of CEECs into the European industrial landscape: on one hand, we observe a relatively strong position of CEECs in some of the more traditional industrial branches characterised by high labour and low skill and technology intensity and, on the other hand, the fastest dynamism or growth takes place in the industrial areas which require higher skills and technology expertise.” (Havlik 2003, p. 27)

Assessments of the changes in the business environment in the CEE4 (Kaitila, Nikula & Karsai 2006) and Polish (Kaitila et al. 2005) markets from the Finnish companies’ point of view reveal that the most positive changes have occurred in the general investment climate, in the performance of the customs authorities, customs operation, business culture, and infrastructure. However, no significant positive changes were found in bureaucracy and legislation, corruption (both in the private and public sector) as well as lad use, landownership and building-site issues. Although these results are based on a less than two years of experience of the EU membership of these countries, and there is a lot of room for improvement, the development has been positive.

Survey assessment of the factors that were expected to strengthen the business opportunities in the 2004 new member states from the Finnish companies’ point of view stress the importance of growing markets (Alho et al. 2004). All the assessed strengthening factors in their approximate order of importance (descending) are as follows:

1. Growing markets in the new member states
2. Low cost level in the NMS-10
3. Expansion of the internal market to the NMS-10
4. Low corporate taxation in the NMS-10
5. Low personal taxation in the NMS-10
6. Good logistic position of the NMS-10
7. The price of energy and raw-materials in the NMS-10
8. Good availability of employees in the NMS-10
9. Difficulties in the availability of employees in Finland (Alho et al. 2004, p. 69).

One indicator of the opening up of the market is public procurement. The EU legal framework for public procurement has created transparency to the demand side of the market. Also in the NMS-10 it has liberalised the award of contracts for non-national suppliers. The effect is evident when looking at the statistics of the number of awards in the NMS-10 in 2004 and 2006 (see Table 10. The number of awards has multiplied in a couple of years.

Table 10. Number of contract awards in the NMS-10.

Country	2004	2006	change 2004-2006 %
Estonia	101	462	457
Bulgaria	0	2	200
Czech Republic	90	2368	2631
Hungary	269	1850	688
Latvia	312	807	259
Lithuania	908	1909	210
Poland	3297	11486	348
Romania	1	116	11600
Slovak Republic	185	732	396
Slovenia	110	690	699

Source: TED (2007)

From the point of view of companies from other EU states operating on the markets in the NMS-10, the most negative factors of the business environment have been the increasing competition and low local purchase power. Also, but to a lesser extent, corruption, other actions taken by local authorities and bureaucracy have been seen as having negative effects on business environment. In practise, business operations in the CEE4 countries have succeeded somewhat worse than expected beforehand. However, there have also been some more positive experiences than expected. The experiences have corresponded to the expectations best in the Czech Republic and worst in Slovakia and Slovenia. (See detailed country-specific data in Kaitila et al. 2005 and Kaitila et al. 2006.)

Assessment of the factors weakening the business opportunities in the 2004 new member states showed that the weaker level of the public administration was perceived the most important factor in this sense. This includes different permission policies, certification systems and corruption. The EU membership was expected to unify these practices with the old member states and consequently make business operations easier. All the assessed weakening factors in their approximate order of importance (descending) are as follows:

1. Weaker level of the public administration in the NMS-10
2. Economical instability in the NMS-10
3. Imperfect infrastructure in the NMS-10
4. Difficulties in the availability of qualified employees in the NMS-10
5. Low productivity in the NMS-10
6. Cultural differences between Finland and the NMS-10 (Alho et al. 2004, p. 69).

All the above mentioned weakening factors are diminishing although some differences compared to the EU15 will exist for a long time (Alho et al. 2004, p. 70). The eventual access of the NMS-10 to the Economic and Monetary Union will bring economic stability. Also, funding from the structural funds and EBRD will facilitate the improvement of the infrastructure.

When looking at the business environment from the local point of view the most problematic factors for doing business in the countries look somewhat different, yet some similarities are found compared to the above described list.[9] The most problematic factors for doing business by country are presented in Table 11.

---

[9] Enlargement effects have been studied increasingly from the point of view of the local business in the NMSs although that viewpoint falls mostly out of the focus of this report. For example, Eurochambres Economic Survey is an annual, qualitative regional survey of business expectations in Europe. The survey is implemented by the European Chambers of Commerce and Industry and co-ordinated by Eurochambres. It is based on a harmonised questionnaire sent to entrepreneurs from the current 25 EU Member States as well as Croatia and Turkey. The questionnaire consists of a set of 12 questions on the companies' past, current and short term business expectations (total turnover, domestic sales, export sales, employment, investment and business confidence).

It seems that the issues concerning the business community in the NMSs are essentially the same as from the point of view of the "old" member states. (Eurochambres 2007) Generally, before the enlargement, the business prospects in the NMSs in 2002-2004 were positive, although with a slightly decreasing trend in the share of respondents assessing the prospects as positive (69%, 60% and 59% of respondents in 2002-2004, respectively). (Eurochambres, 2004, p. 26) In 2007 the share of positive business confidence varies from 66% in Bulgaria and 63% in Lithuania to 29% in Estonia and 19% in Hungary (Eurochambres 2007).

Table 11. The most problematic factors for doing business by country.

	Estonia	Bulgaria	Czech Republic	Hungary	Latvia	Lithuania	Poland	Romania	Slovak Republic	Slovenia
Inadequately educated workforce	**21.87**	7.04	2.36	7.15	6.74	10.38	0.60	4.80	5.94	8.06
Inefficient government bureaucracy	**12.93**	**13.65**	**12.11**	**10.77**	11.93	**16.07**	7.62	**14.86**	**22.20**	**14.05**
Poor work ethic in national labour force	**10.29**	4.11	3.62	5.47	3.39	2.12	1.81	4.60	5.49	3.99
Tax rates	8.12	7.48	**13.60**	5.80	**12.48**	**16.61**	8.53	**12.92**	2.35	**18.40**
Inflation	7.45	2.71	0.16	4.77	13.16	1.54	5.74	2.73	1.46	2.00
Inadequate supply of infrastructure	7.25	9.10	4.87	**10.86**	6.78	3.03	5.51	8.39	**19.28**	5.85
Access to financing	6.30	**12.84**	11.95	9.97	9.99	6.81	5.06	11.13	8.30	6.49
Restrictive labour regulations	6.30	5.68	11.95	5.30	1.49	6.81	5.06	2.93	6.61	13.55
Tax regulations	5.28	9.68	**17.06**	**14.12**	11.12	**15.86**	**14.42**	11.86	3.81	**20.54**
Policy instability	4.67	3.67	7.47	6.88	3.84	5.44	**13.36**	9.93	3.03	0.71
Corruption	4.47	**12.40**	10.61	5.91	**12.21**	10.55	**11.85**	**12.92**	**15.92**	2.64
Government instability/scoops	2.44	4.11	0.71	1.50	4.79	2.82	10.04	0.73	1.35	1.43
Crime and theft	2.17	6.97	2.20	0.88	1.13	1.91	9.66	1.33	3.70	0.93
Foreign currency regulations	0.47	0.66	1.34	0.62	0.95	0.04	0.75	0.87	0.56	1.36

Note: From a list of 14 factors, respondents were asked to select the five most problematic for doing business in their country/economy and to rank them between 1 (most problematic) to 5. The figures show the responses weighted according to their rankings. Top3 factors per country are presented in bold.

Source: World Economic Forum (2006)

The most problematic areas in the countries are government bureaucracy, tax related issues and corruption as can be seen from Table 11. Estonia forms an exception: although bureaucracy is seen as the biggest problem there, workforce related issues form the second largest problem. Bulgaria faces problems with access to financing whereas policy instability is problematic in Poland.

4.2 Competition

Before the EU eastern enlargement many industries feared that they will lose business to low wage economies of the applicant countries. (e.g. Zuleeg 2002; Mirola 2006) Increasing competition is in part driven by the low relative labour costs. Sensitive areas for the union as a whole were expected to include especially labour-intensive sectors, including for example low cost assembly plants. Substantial pressure was expected to arise also for the mechanical and electrical engineering and chemical sectors in the EU countries. (Zuleeg 2002)

Havlik (2003, p. 30) analyses the changes in shares (over the period 1995-2001) of the different economies in 'enlarged intra-European trade' flows (this is defined as comprising intra-EU15 trade flows as well as the trade flows between the EU15 and the CEEC10 in both directions). There are substantial inroads made by the CEECs into intra-European trade flows, this time at the cost of a much wider range of EU15 economies. The only countries which gained shares in intra-European trade were Austria and the cohesion countries Spain, Portugal and Ireland.

Havlik (2003) found that during the period 1995-2001, CEECs' market share in an enlarged EU25 grew by 2.6 pp (to 6.1%), largely at the expense of reduced market shares of France, Germany, Sweden, Belgium/Luxembourg and Denmark. Judged by the correlation between the respective export market share gains and losses across all subsections of manufacturing, the CEECs seemed to compete mainly with exports from Spain, Portugal, Ireland, Austria, Germany and France. CEEC8 market share gains in EU25 were correlated with market share losses of industries in intra-EU trade (including exports of Austria, France, Germany and Spain). Based on this evidence, the Czech Republic competes on the European market with Ireland and Spain; Hungary with Austria, Germany and France; Poland with Austria and France; Estonia with Denmark and Sweden; Bulgaria and Romania compete mostly with the Southern cohesion countries Greece and Portugal as well as with Italy.(Havlik 2003, p. 24)[10]

[10] For more detailed figures, see Havlik 2003, p. 24, table 4.3.

With respect to the changing shares of CEECs' industry in production of the overall EU25 economy, we can see that "there were substantial shifts on production shares in the integrated European economy – the EU25 – in favour of the CEEC10. There were relatively large losses of the German industry in production shares over this period 1995-2001. A number of other economies such as Austria, Belgium and Denmark joined Germany as economies which experienced the largest declines in manufacturing production shares in the enlarged EU economy whereas Finland, United Kingdom and Spain increased their shares in industrial output of a enlarged EU25." (Havlik 2003, p. 27)

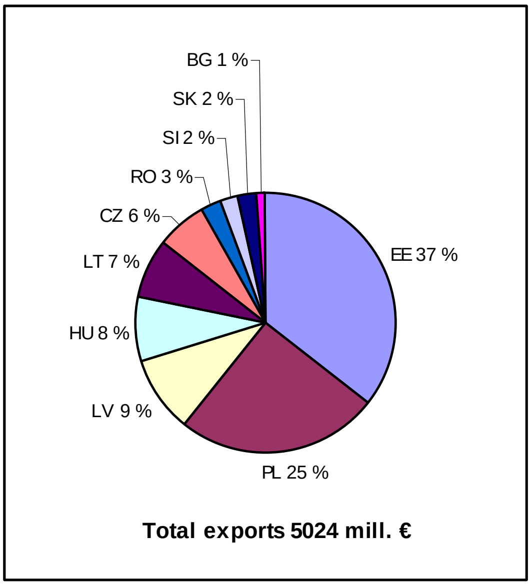
4.3 Exports/imports

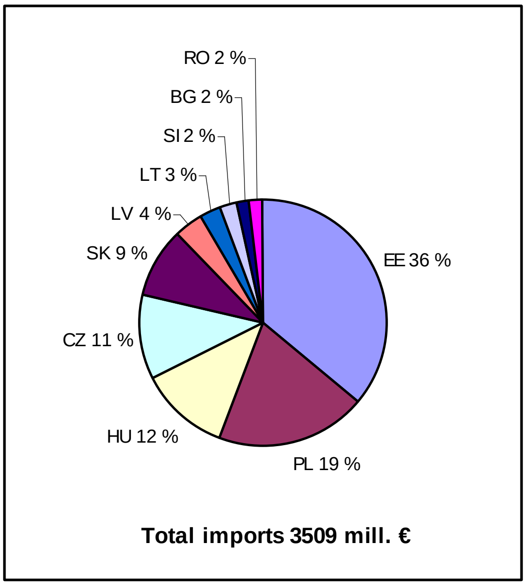
Trade with the new member countries was free for the most part already by the Europe Agreements and the institutional and structural development had progressed fast before the accession. Therefore the enlargement effects on the EU15 economic development in general were quite limited. Trade was also not affected very much.

Finnish exports to the new member countries in 2006 were 5024 million euros, which was about 8.2% of the total exports. The respective value of imports was 3509 million euros which was about 6.4% of total imports. In the last 3 years (2004-2006) the exports have grown approximately 27% (imports 25%). During this time the NMS-10 share of total Finnish exports has grown 0.7 percentage points while the share of total imports has remained at the 2004 level. (Tullihallitus 2007)

Estonia is the largest trading partner in the Finnish trade with the NMS-10. Its share total Finnish of exports and imports to the NMS-10 is over 35%. Poland is the second largest with 25% share in exports and 19% in imports, followed by Latvia in exports (9%) and Hungary in imports (12%). The division of Finnish trade with the new member countries in 2006 is presented in Figure 10.

Figure 10. Finnish trade with the NMS-10 by country in 2006.

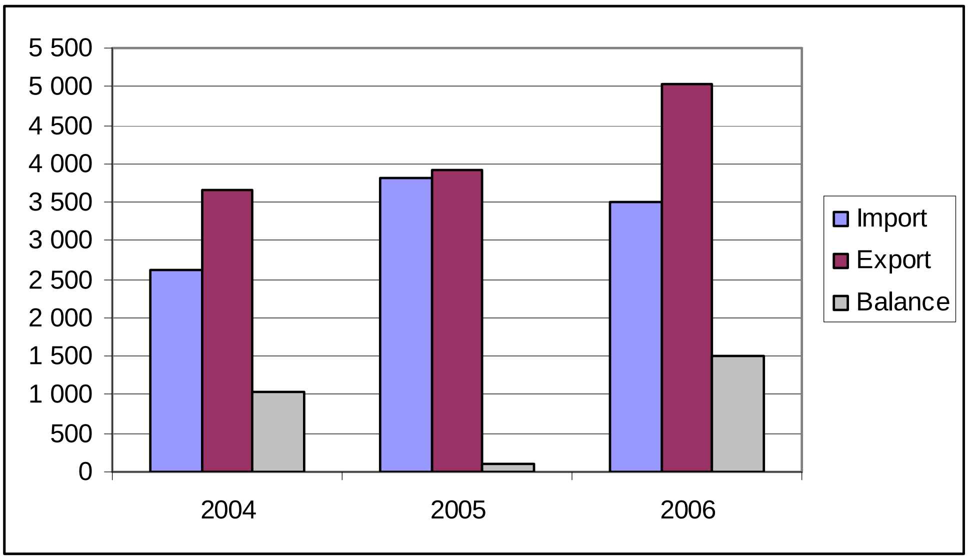




Source: Tullihallitus

Finnish trade with the NMS-10 has grown somewhat faster the total trade. During 1994-2003 import growth was more intensive, although the share of NMS-10 also grew in exports. In 2004 it was predicted that the same trend would continue in the near future. Trend extrapolation to the year 2010 predicted that if the trend continued the Finnish trade balance would show deficit with the Baltic States in 2007 and with the other countries 1 to 2 years later. (Teollisuus & Työnantajat 2004, p. 25) However, when looking at the data for years 2004 to 2006 it is clear that the trend has broken and exports show faster increase than imports (see Figure 11).

Figure 11. Finnish trade with the NMS-10 in 2004-2006, mill. euros.



Source: Tullihallitus

The structure of Finnish trade with the NMS-10 is very similar to the EU15 trade. The share of technology industry is over 50% both in the exports and imports. Second largest share of exports to the NMS-10 from Finland is in pulp and paper products as well as chemical products. In imports the second largest share is in wood and wood products, such as furniture, and the third share is in textiles and clothing. (Teollisuus & Työnantajat 2004, p. 12)

Finnish companies operating on the CEE4 and Polish markets estimate that their exports there increase during the period of 2006-2011 (2005-2010 for Poland). Export to Czech Republic and Slovakia are estimated to increase less than 10% per year, while exports to Hungary and Slovenia are estimated most frequently to increase by over 10% per year. (Kaitila et al. 2006) Respective estimates on exports to the Polish market indicate increase in 60% of cases. The increase varies from less than 10% to over 25% per year. (Kaitila et al. 2005) Poland and Lithuania have been among the fastest growing export markets of Finnish companies already before their EU accession (see e.g. Mirola 2006, p. 102).

4.4 Costs

Labour costs play their role in shaping relative cost structures and hence the competitive position of different industries. Survey results show that the average monthly labour costs in CEECs' manufacturing amounted to just 14% of EU average in the year 2000 (Eurostat, 2000). Generally, CEECs' labour costs (wages) have been growing rather fast recently. In the last couple of years they have been pushed up also by currency appreciations. Notably, nominal (EUR-based) wages in all CEECs (except Slovenia) have been rising faster than in the old EU. Although this can be considered a positive sign with regard to cohesion and catching-up, the rapid wage increases are putting a strain on the CEECs' international cost competitiveness – unless these are compensated by a corresponding raise in productivity and other efficiency improvements. (Havlik 2003, p. 23)

Unit labour costs (ULC) in the transition economies (TEs) were in Western comparison generally low in the mid-1990s. Thus labour intensive activities were obviously attracted to the TE-region. From the investors' point of view, the scene changed rather rapidly: Unit labour costs in TEs showed steep increase. (Tiusanen 2003) During the 21st century the cost increase pace has slowed down, even dramatically in some countries. For example, compared to the period of 1995-2002 the growth rate of 1999-2006 in Poland has slowed from 110% to 13.7% and in Lithuania from 122.7% to 10.6% (see comparisons in Table 12). The average growth rate has decreased from nearly 70% in 1995-2002 to less than 30% in 1999-2006.

Table 12. Unit labour costs (PPP adjusted), Austria=100.

	1999	2002	2005	2006 prelim.	Growth% 1999-2006	Growth% 1995-2002
Czech Republic	29.32	38.72	41.30	42.96	46.5	95.7
Hungary	26.05	35.80	39.54	37.88	45.4	78.9
Poland	39.35	44.88	43.13	44.75	13.7	110.0
Slovak Republic	23.24	26.82	33.44	35.60	53.2	37.1
Slovenia	64.96	67.55	69.17	68.14	4.9	20.5
Bulgaria	16.40	16.75	19.31	20.28	23.7	44.9
Romania	25.87	27.77	35.43	38.93	50.5	57.1
Estonia	35.94	37.54	39.42	42.35	17.8	63.3
Latvia	32.25	33.39	31.58	34.95	8.4	66.0
Lithuania	30.10	29.82	30.89	33.31	10.7	122.7
NMS-10 average	32.35	35.90	38.32	39.92	27.48	69.62

Source: WIIW (2007); Tiusanen (2003)

The fastest unit labour cost growth from 1999 to 2006 is registered in Slovak Republic (53.2%9), followed by Romania (50.5%). Even after this increase, their ULC levels remain only one third and less than 40% of the Austrian level, respectively. The most modest growth rates 1999-2006 have been in Slovenia and Latvia.

Bulgaria shows the lowest UCL level in the new member countries, making it the most attractive country for labour intensive industries labour cost wise. Slovenian labour costs level (68%) is the highest in the NMS-10 and more than triple that of the Bulgarian level.

The average annual ULC growth in 2005-2006 is 4.9%, with the highest growth in Latvia (10.7%) and lowest in Poland (3.8%) while the growth has declined in Hungary and Slovenia.

4.5 Labour force issues: migration and employment

Before the 2004 enlargement it was feared that the enlargement could lead to a new inflow of immigrants attracted by substantial higher wages in the “old” EU. Although immigration could ease the expected shortages on the EU labour markets, hostility towards immigration has appeared in almost all member states. (Van der Putten 2002) Immigration is among the five most frequently mentioned concerns of European citizens. About 14% of citizens cited this issue among the two most important issues facing their country. It should be noted, however, that immigration is seen a concern far more frequently in the EU15 (17%) than in the NMS-10 (3%). (Eurobarometer 2007, p.26)

Before the 2004 accession countries joined the EU, Zuleeg (2002) summarised what was expected as follows: “As long as the living standards remain low in the accession countries, migrations is likely regardless of enlargement. If enlargement can produce a real convergence of living standards, it can contribute to relieve migratory pressure.” Fears were expressed that enlargement would result in job losses in the old member countries as trade and investment would be attracted to be located in the new member countries. However, the re-direction of trade and investment flows is part of the general globalisation process, which would have taken place irrespective of the European Union enlargement.

Although there are no precise figures, it is believed that a large number of young workers from the new member states have migrated to the western part of the EU. This migration is primarily from Poland and the Baltic countries mostly to the United Kingdom and Ireland. It may have had some, although probably limited impact on the decrease in unemployment rates. Also, it is commonly assumed that rather large numbers of Romanians and Bulgarians have been moving to the old EU, especially to Italy and Spain. The direct impact of these migration flows on domestic unemployment is, however, difficult to measure. (Gligorov et al. 2007, p. 21)

One has to bear in mind though, that transitionary stipulations imposed on labour flows between some EU15 members (mainly Austria and Germany) restrict the labour flows for a period of up to seven years after EU accession. (Havlik 2003, p. 17)

The free movement of labour force after the transition periods enables the hiring of cheaper labour from the NMS-10 the productions in the EU15. However, since the employees from the NMS-10 are to be treated equal to the local labour force i.e. at the same wages, the benefits of this possibility remain very limited. Of course, the potential migration helps sectors which suffer from labour shortage. Such sectors include especially services and construction, but also technology industry faces recruiting problems. (Teollisuus & Työnantajat 2004)

According to recent Eurobarometer (2007) results, almost 50% of the citizens in EU25 see unemployment as one of the two most important issues facing their country. It is the main worry among citizens. At 63%, concerns about unemployment continue to affect a much broader spectrum of the population in the NMS-10 than is the case in the fifteen old member states (46%).

However, in most new member states, unemployment is relatively low (see Table 13). The average unemployment rate for NMS-10 in 2006 was 10.4% while the respective rate in EU15 was 7.3%. This brings the total EU27 rate to 7.9%. In the NMS the rates are dropping consistently, albeit unspectacularly (Gligorov et al. 2007, p. 21). Hungary is an exception: unemployment is rising, but this has been expected given the recent and upcoming economic growth slowdown. Relatively high GDP growth has been needed to generate new jobs (Havlik 2005). The highest unemployment rates are in Poland (15%) and Slovakia (13.5%). These rates are decreasing quite fast.

Table 13. Unemployment, annual averages.

	in 1000 persons	**Rate in %**					**Forecast**		
	2006[1]	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Czech Rep.[2]	380	8.1	7.3	7.8	8.3	7.9	7.3	6.7	6.5
Hungary	317	5.7	5.8	5.9	6.1	7.2	7.5	7.9	7.8
Poland	2500	18.2	19.9	19.6	19.0	17.8	15.0	14.0	13.0
Slovak Rep.	360	19.2	18.5	17.4	18.1	16.2	13.5	12.0	11.0
Slovenia	64	6.4	6.4	6.7	6.3	6.6	6.3	6.0	6.0
NMS-5[3]	3621	14.5	15.3	15.1	14.9	14.1	12.2	11.5	10.8
Bulgaria	310	19.7	17.8	13.7	12.0	10.1	9.0	8.0	7.0
Romania	700	6.4	8.4	7.0	8.0	7.1	7.0	7.0	7.0
Estonia	40	12.6	10.3	10.0	9.6	7.9	6.8	5.0	4.5
Latvia	79	13.1	12.0	10.6	10.4	8.7	6.7	6.2	6.0
Lithuania	93	17.4	13.8	12.4	11.4	8.3	5.8	5.0	5.0
NMS-10	4843	13.0	13.8	13.0	13.9	11.9	10.4	9.8	9.3
EU27[4]		8.5	8.9	9.0	9.1	8.7	7.9	-	-
EU15[4]		7.2	7.6	8.0	8.1	7.9	7.3	-	-

Notes : 1) Preliminary, 2) From 2002 weighted according to census 2001, 3) wiiw estimate, 4) From Eurostat, 2006 not forecast.
Source: Gligorov et al. 2007 p. 21; Eurostat

In both Poland and Slovakia, falling unemployment rates relate directly to the growing demand for labour. The demand for labour also remains strong in the Baltic countries. Relatively low growth rates of employment (e.g. in the Czech Republic or Romania) do not necessarily reflect weak demand for labour. To some extent they may indicate the complete antithesis: a labour shortage. For example, in Poland firms are finding it increasingly difficult to hire the employees they urgently need. The current growth in output is constrained by labour shortages. Large regional variances in the availability of jobs and affordable housing may also be preventing a more efficient matching of supply and demand on the labour market. (Gligorov et al. 2007, p. 22)

Gligorov et al. (2007, p. 22) warn that the Polish experience suggests that other NMS-10 may soon start reporting labour shortages:

> *"Indeed, labour shortages are already surfacing in the Czech Republic, Bulgaria and Romania. This may have far-reaching macro--consequences – not only on account of labour bottlenecks limiting production growth. The stronger position that employees are now assuming may well prove conducive to a higher share of income going to labour. Last, but not least, more expensive labour may accelerate the shift towards labour-saving technology. Of course, these are all long-term consequences of a tightening labour market, whereas the further decline in unemployment rates (especially in Poland and Slovakia) expected to occur in the period 2007-2008 is more a medium-term outcome."*

In fact, also Romania is faced with growing shortage of labour. About 10 % of its labour has found employment in the old EU countries. Romanian industry has started to import labour from China to ease the chronic labour shortage in the country. (Majaniemi 2007b)

The labour force is seen problematic also from the point of view of education. The Global Competitiveness Report summarises the factors seen by business executives as the most problematic factors for doing business in their economy. The information is drawn from the Executive Opinion Survey where the respondents were presented with 14 different factors and asked to rank from 1 (most problematic) to 5 those they considered the most problematic. The results are weighted according to the ranking assigned by the respondents. (World Economic Forum 2006) The report shows that inadequately educated labour force is a somewhat problematic factor for doing business in all the NMS-10. It is considered the most problematic in Estonia whereas the Polish rank it the least problematic factor in their economy. However, this is not to say that it is not problematic also in Poland but the other factors are seen even more problematic there. Table 14 shows the responses concerning labour force according to their rankings by country.

Table 14. Inadequately educated work force as a problem.

	Weighted rankings	Rank among the 14 factors
Czech Republic	2.36	10
Hungary	7.15	6
Poland	0.60	14
Slovak Republic	5.94	6
Slovenia	8.06	5
Bulgaria	7.04	7
Romania	4.80	8
Estonia	21.87	1
Latvia	6.74	8
Lithuania	10.38	5

Education becomes even more relevant issue as the labour cost convergence progresses. Already, the labour costs in the most simple low productivity activities such as assembly the labour cost level is above that of China and Russia (Teollisuus & Työnantajat, 2004). Therefore these jobs have been relocated more and more in to those countries where production costs are lower and the trend will probably even accelerate in the future. More especially higher educated labour force is then needed in the production industries in the NMS-10.

4.6 Crime and fraud

After unemployment (49%), crime (24%) is the second most frequently mentioned concern among EU citizens. In the fifteen old member states, the extent to which crime is a concern ranges from 12% in Germany and Luxembourg to 54% in Ireland. In the new member states, concern is most widespread in Cyprus (49%) and least widespread in Slovenia (9%). (Eurobarometer 2007)

In Finland, survey results (Mirola 2006) on the export companies’ fears of the possible negative effects of the 2004 enlargement reveal that the criminal issues have not been considered to have any major effects. Only a couple of the 245 participant companies mentioned crime, in general, to worry them. However, in the survey no distinction was made weather the mentioned “crime” would consider criminality in the new member countries or the possibility of criminal activity from those countries to Finland. The respondents did not specify, what kind of criminal activity they feared, with the exception of plagiarism which is related to counterfeit products.

4.6.1 Counterfeit and piracy

Counterfeit and piracy have become an international phenomenon with considerable economic and social repercussions. They also affect the proper functioning of the single market and impact on consumer protection, particularly with regard to public health and safety. This situation causes deflections of trade and distortion of competition, leading to a loss of confidence on the part of operators in the single market and a reduction in investment. (Scadplus 2007a)

These activities are estimated to represent between 5 and 7% of world trade and a global loss of 200 000 jobs per year. Moreover, European Union businesses with international activities are estimated to lose between 400 and 800 million in the single market and around 2000 million outside the EU. (Scadplus 2007a)

There was a 1000% increase in counterfeiting and piracy between 1998 and 2004. In 2004 alone, 103 million fake or pirated articles were seized by customs officials in the European Union; 4.4 million of these were fake foodstuffs and alcoholic drinks. Much of this traffic is sold on the black market, which means losses of tax revenue for Member States. (Scadplus 2007b)

In 2004, in addition to the usual types of products retained by customs (such as luxury items, cigarettes, DVDs, CDs, textile goods etc.), fake goods seized by customs at EU borders included: mineral water, jam, mobile phones, coffee, apples, face creams, flowers, car parts, washing powder, pharmaceuticals, razors, toothpaste and brushes etc. Most of the products seized are household items, with growing numbers of sophisticated hi-tech products being faked. The quality of these counterfeits is now so good that it is becoming difficult to distinguish the real article from the fake. What is more, high profits and relatively low risks make counterfeiting and piracy lucrative for those involved in organised crime. (Commission of the European Communities 2005) European Commission reminds of the seriousness of the problem:

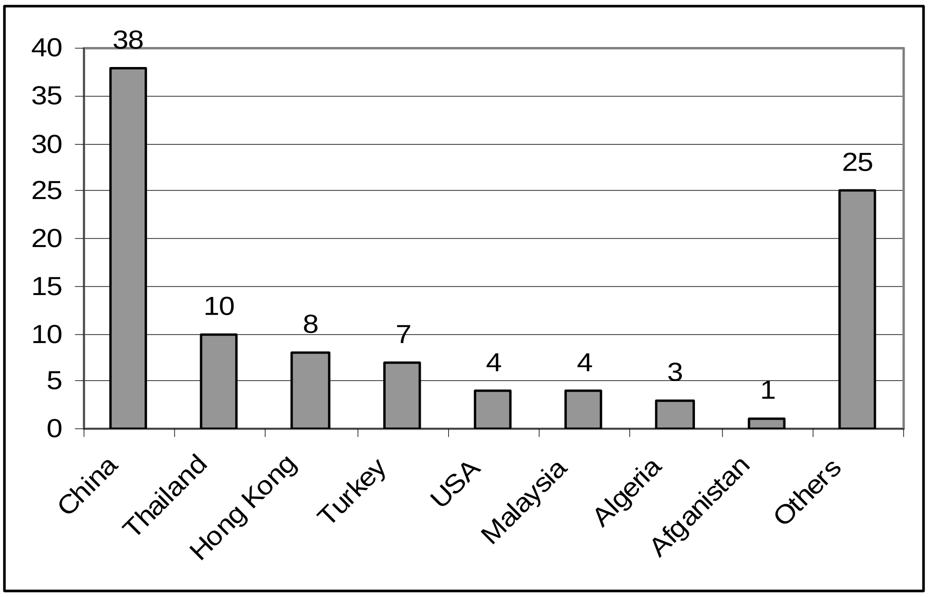
> "*There are now few doubts regarding the implication of international criminal organisations in the worldwide trafficking of counterfeit and pirate goods. International traffickers often make use of free zones to tranship goods, and these free zones are fertile ground for importing and exporting counterfeit and pirated items. These activities have become a source of income in exactly the same way as narcotics, theft and arms dealing. To make a comparison, a kilo of cannabis leaf will*

fetch 2000 euros in Europe, whilst a kilo of pirate or counterfeit CDs will fetch 3000 euros." (European Commission 2007)

Breakdown of the counterfeit cases by the area of law shows that most of the counterfeit cases violate trademark (79%), followed by designs and models (7%), copyrights and related rights (5%) and patents and supplementary protection certificates (1%). (European Commission 2005)

However, the concern that the enlargement of the Union would have increased the problem of counterfeits manufactured inside the Union, may be ungrounded, since statistics show that the origin of the counterfeit products is Asia in about 60% of cases, Turkey in 7% of cases and USA in 4% (See Figure 12). (European Commission 2005)

Figure 12. The number of counterfeit cases by origin of goods in 2005, % of total.



Source: European Commission (2005)

Breakdown of the counterfeit statistics by the number of cases by origin/provenance and product type reveal some interesting points. For example, in 2003, there were two European countries among the seven countries from where counterfeits foodstuff, alcoholic and other drinks originated most often. The share form Poland was 18% whereas the share from Spain was 6%. Respectively, 3% of counterfeit clothing and accessories came from Czech Republic and 2% from Poland. Poland was the origin also in 30% of cases in cigarettes, 2% in computer equipments and 6% in watches and jewellery. Switzerland was at the top-7 of the statistics in perfumes and cosmetics (3%), computer equipment (7%) and toys and games

(1%), while Belgium was the fourth most frequent source of CD, DVD, cassettes etc. with a share of 9%. (European Commission 2003a)

In the 2005 statistics Poland and Czech Republic were not in the top-7 countries of origin in any product type category whereas the share of Bulgaria was 22% in perfumes and cosmetics, 4% in food, alcoholic and other beverages and 3% in electrical equipment. The share of Switzerland was 1-2% in 8 out of 14 product categories. (European Commission 2005)

Comparison of the number of counterfeit cases by type of traffic shows that 64% of cases were commercial and 34% passenger traffic cases in 2004. In Finland the respective figures were 93% and 7%. (European Commission 2004)

4.6.2 Corruption

Corruption is another negative issue combated in the union. Corruption was a major preoccupation during the 2004 and 2007 enlargements of the EU. However, not being in the core of the EU acquis, anti-corruption was a relatively new matter to tackle and, in contrast to other areas of EU competence, it had little specific guidelines to offer applicant countries. Yet, the significance of transparent and accountable government for the functioning of the internal market and the delivery of its core policies required that anti-corruption be made one of the key requirements for membership. (CSD 2007)

The perception of bribery is culturally relative and it is true that conscience is “culturally conditioned”. In some countries, the same action may be considered a tip to ensure promptness or service, especially when dealing with bureaucracy. Among government officials in many countries the ethical dilemma has also been labelled “influence peddling”. There is a fine line between legal and illegal or even immoral behaviour. (Harris 2001)

European Union aims to reduce all forms of corruption, at every level, in all EU countries and institutions and even outside the EU (European Commission 2003b). Corruption involving European Community officials (Council 1997) as well as the private sector (Council 2003) is tackled.

In its communication on a comprehensive EU policy against corruption the Commission states the following:

> *“The Commission wants to focus initiatives on preventive measures designed to avoid conflicts of interest and to introduce systematic checks and controls. It calls for steps*

> *to raise integrity in the public sector and recommends a comprehensive dialogue on minimum standards and benchmarking.*
>
> *In order to raise integrity in the private sector, the Commission calls on the professional associations of notaries, lawyers, accountants, auditors and tax consultants to continue to tighten up their self-regulatory regimes. In order to enhance corporate responsibility, it urges companies, which may be both offenders and victims of corruption, to apply modern accounting standards, to adopt adequate internal audit schemes and codes of conduct, and to establish clear rules on whistleblowing. There is a need to raise awareness in the private sector as a whole, and the Commission intends to continue to stimulate the dialogue between the public and the private sector through initiatives such as the EU Forum on the prevention of organised crime."* (European Commission 2003b)

The magnitude of the problem is evident as shown by the following example of corruption in public contracting: Transparency International Czech Republic has published a study of procurement processes, revealing that more than 1 billion € of public funds are lost each year in the Czech Republic due to a lack of transparency in public procurement. Corruption in public contracting plays a significant role in the delivery of goods and services in many countries. With approximately 70 percent of central government expenditure spent on such contracts, the impact of corruption can be enormous. (Transparency International 2005)

Transparency International's Corruption Perceptions Index is a composite index that draws on multiple expert and business opinion surveys that poll perceptions of public sector corruption in 163 countries in the world. The CPI Score scores countries on a scale from zero to ten, with zero indicating high levels of perceived corruption and ten indicating low levels of perceived corruption. (Transparency International 2006)

EU15 countries score highly clean in terms of corruption and rank among the top-26 countries in the world with the exceptions of Italy and Greece, which rank 45 and 54, respectively. The 10 new member countries rank from 24 (Estonia) to 61 (Poland) and 84 (Romania). Transparency International reports that countries with significant improvement in perceived levels of corruption include Czech Republic, Latvia and Slovenia. (Transparency International 2006)

Table 15. Corruption perception index 2006.

Country	Rank	Score	Country	Rank	Score
Finland	1	9.6	Estonia	24	6.7
Denmark	4	9.5	Malta	28	6.4
Sweden	6	9.2	Slovenia	28	6.4
Netherlands	9	8.7	Cyprus	37	5.6
Austria	11	8.6	Hungary	41	5.2
Luxembourg	11	8.6	Czech Rep.	46	4.8
United Kingdom	11	8.6	Lithuania	46	4.8
Germany	16	8.0	Latvia	49	4.7
France	18	7.4	Slovakia	49	4.7
Ireland	18	7.4	Bulgaria	57	4.0
Belgium	20	7.3	Poland	61	3.7
Spain	23	6.8	Romania	84	3.1
Portugal	26	6.6	NMS-10	-	4.8
Italy	45	4.9	EU15	-	7.7
Greece	54	4.4	EU27	-	6.5

Source: Transparency International (2006)

5 Companies' actions in the enlarged European Union

5.1 Strategic responses

The location of the markets provides one variable relevant to identifying the strategies companies choose. On this basis, Staniland (1997) classifies the EU15 countries as follows:

1. those European countries that offer large and central markets (France, Germany, the UK);
2. those that offer small but central markets (Belgium, Luxembourg, the Netherlands);
3. those that offer large but peripheral markets (Spain, Italy); and
4. those that offer small and peripheral markets (Austria, Denmark, Finland, Greece, Ireland, Portugal, and Sweden).

The 2004 and 2007 EU enlargements brought a new group of countries to the European home market. This group can be characterised as follows:

5. New and emerging, relatively small (with the exception of Poland) and mostly peripheral markets (Estonia, Lithuania, Latvia, Hungary, Slovakia, Slovenia, the Czech Republic, Malta, Cyprus, Poland, Romania and Bulgaria)

Staniland (1997) reminds that, to the extent that establishment in a large national market or populous EU region provides the basis for more competitive firms that can harvest economies of scope and scale, integration may occur at a cost to the companies based on the periphery of the Single Market. Their strategies are, therefore, likely to be defensive in character or certainly quite different from those of their more fortunately located rivals. Naturally, differences also arise in the strategies of the companies exporting to these markets. For example, export strategies adopted for the large and central markets may be totally unsuitable for exports to those countries that joined the EU in 2004 and 2007.

In the 1995 business survey (European Commission 1997), some 13 500 European enterprises answered the question of the Single Market Programme's (SMP) impact on their business strategies. The strategy areas studied included product, production, marketing and distribution, sourcing as well as acquisition, cooperation and ownership strategies. Each of these areas was divided further into more specific items. Although the Single Market was thought to have major implications for the development of business strategies, the survey showed a limited impact at that time. European business appeared to have been rather sceptical about the SMP's impact as some 43 to 60 per cent of enterprises in the manufacturing sector reported little or no importance on their strategies.

According to the survey results (European Commission 1997, Table EUR M.3.), in the manufacturing sector, the SMP was considered as having been most important in research and development of new products, with some 44% of enterprises perceiving the SMP as either very important or quite important. R&D is followed, in order of importance, by pricing (36%), purchase of raw materials from other EU markets (34%) and penetration of EU markets (32%).

Results weighted by the number of employees show the most affected strategy areas in somewhat different order. Some 42% of the manufacturing sector reported the SMP being either very important or quite important in promoting purchases of raw materials from other EU markets. Over 35% of the manufacturing sector perceived some importance also, in declining order, in pricing, penetration of EU markets as well as research and development of new products. (European Commission 1997, p. 17 & Table EUR M.3)

Changes in the expectations of the Finnish companies of the influence and importance of EU integration on their strategies from the beginning of the 1990s to the time of the Finnish accession have been reported only in a few studies (e.g. Tuulenmäki 1990; Tuulenmäki & Virtanen 1990; Kaitila 1996). Mirola (2006) has studied how the establishment of the Single Market and integration process in general are affecting the parameters of corporate strategies and how they are causing differentiation between companies. The research setting on strategy issues followed, for the most part, the Commission study (European Commission 1997). Note, however, the different scales used in the questionnaires as well as the EU enlargements that have been carried out since the Commission study. In the Finnish study (Mirola 2006) the importance was measured on a 6-point scale from 0=no importance to 5=very important. At the time of the Commission study, the union consisted of 12 states, whereas the Finnish study covers the EU15. In addition, business strategies at the time of the Finnish data collection, in 2003, were likely to already reflect the 2004 enlargement and also its effects on the market situation.

In the Finnish study, the respondents were asked to give their judgement on the importance of European integration and the Finnish membership to the development of 18 given areas in the company’s strategy. Summary of the data is presented in Table 16.

Table 16. Importance of European integration on companies' strategies.

Strategy area	Mean	Std.dev.
Investment and cooperation		
Investments in other companies	0.6	1.02760
Purchase of financial services from other EU-countries	0.5	.95798
Investment from other companies	0.6	1.13871
Purchase of business services from other EU-countries	0.7	1.00712
Co-operation agreements with other companies	1.5	1.48017
Establishment of new production plants in EU-countries	0.8	1.24428
Product		
Product standardisation	1.8	1.70279
Product specialisation	1.6	1.56517
Pricing	2.1	1.53072
Research and development of new products	1.9	1.54446
European Union market		
Market entry in EU-countries	1.4	1.41357
Distribution channels in EU-countries	1.5	1.51168
Advertising in EU-countries	1.0	1.29210
Pan-European packaging and labels	1.3	1.46226
Sourcing		
Purchase of components from EU-countries	1.5	1.50897
Purchase of raw materials from EU-countries	1.6	1.56109
Domestic capacity		
Number of domestic production plants	0.7	1.11947
Existing domestic production capacity	1.3	1.37645

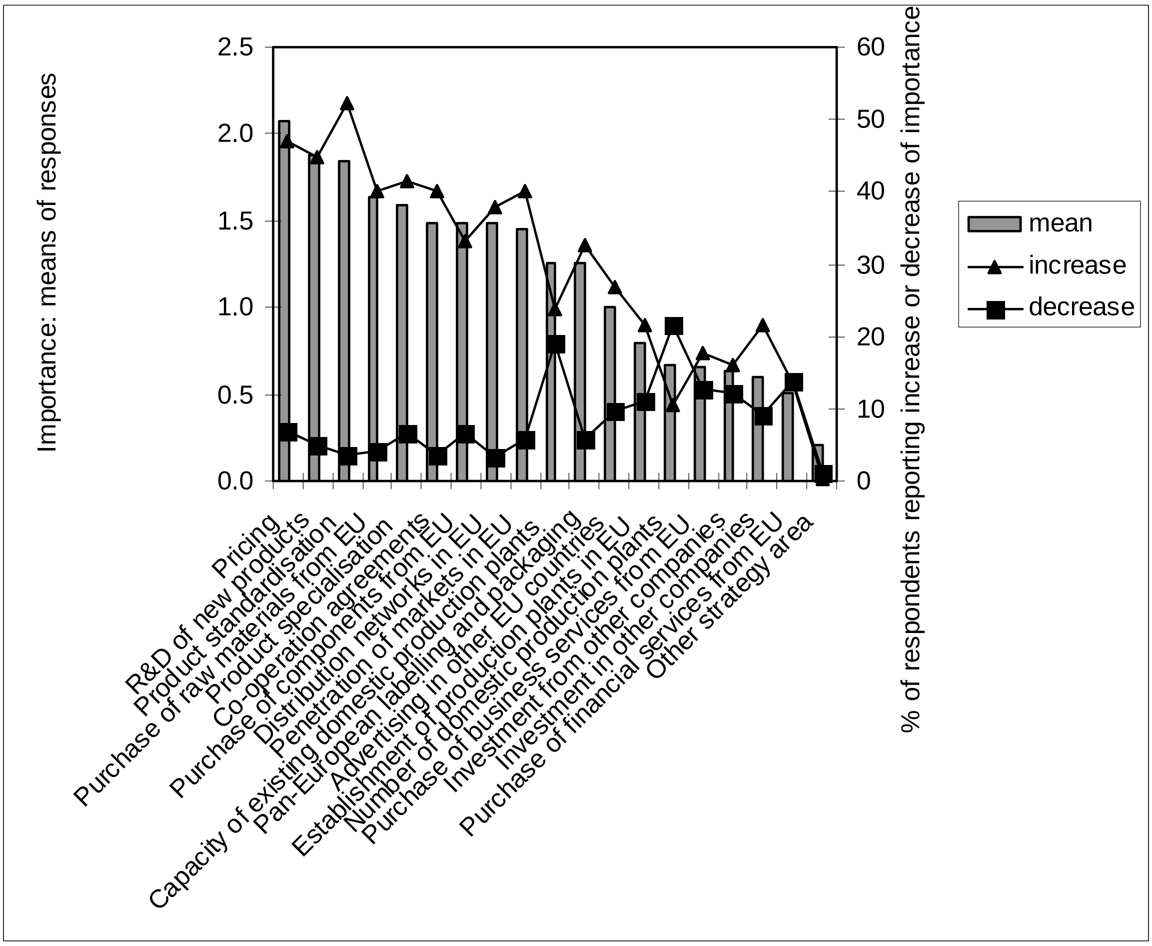
Note: Importance measured on a 6-point scale of 0=no importance to 5=very important.

From the point of view of Finnish manufacturing companies, the importance of the EU is the most obvious in product-related strategies but clear also in sourcing and market entry strategies. It has had very little importance in investments and resources strategies.

The EU effect is most important in pricing strategy, research and development, product standardisation, purchase of raw materials from other EU countries and specialisation. The EU impact on cooperation agreements with other companies is reported to have more importance by Finnish companies than by other EU companies previously. However, the EU was more important in the penetration of markets from the point of view of companies in other EU countries than in Finland. (Mirola 2006, p. 155)

Estimates have also been given whether the importance of EU effect in each strategy area will increase or decrease as the integration deepens and widens. Especially the 2004 enlargement is expected to have influenced these estimates. The estimated change of the EU importance on each of the strategy areas is depicted in Figure 13. The lines show the percentage of respondents reporting increasing and decreasing EU importance. However, it should be noted that the share of companies reporting no change/non-response was relatively high, between 44 to 72 per cent.

Figure 13. Importance of EU on companies' strategy areas.



Note: Importance of EU on strategy areas on a scale of 0 to 5 as columns on the primary axis. Percentage of respondents reporting increasing and decreasing importance as lines on secondary axis.
Source: Mirola (2006, p. 156)

An interesting correlation was found between the EU importance and the direction of its anticipated change. Generally, the higher the importance had been, the more frequently it was expected to increase. Thus, increasing EU importance was reported the most frequently in standardisation, pricing, R&D of new products and specialisation. Increasing importance was expected frequently also in sourcing strategies, i.e. in purchases of raw materials and components from the EU.

The expected EU effect on the number of domestic production plants was decreasing more frequently than increasing (22 % and 11% of respondents, respectively), but the effect on the domestic production capacity was decreasing almost as frequently as increasing (19% and 24%). This indicates that domestic capacity strategies were developed irrespective of anticipated changes in the EU, i.e. the companies did not foresee any development in the union which would have significant increasing or decreasing importance in their domestic capacity. (Mirola 2006, p. 156)

5.2 Investments

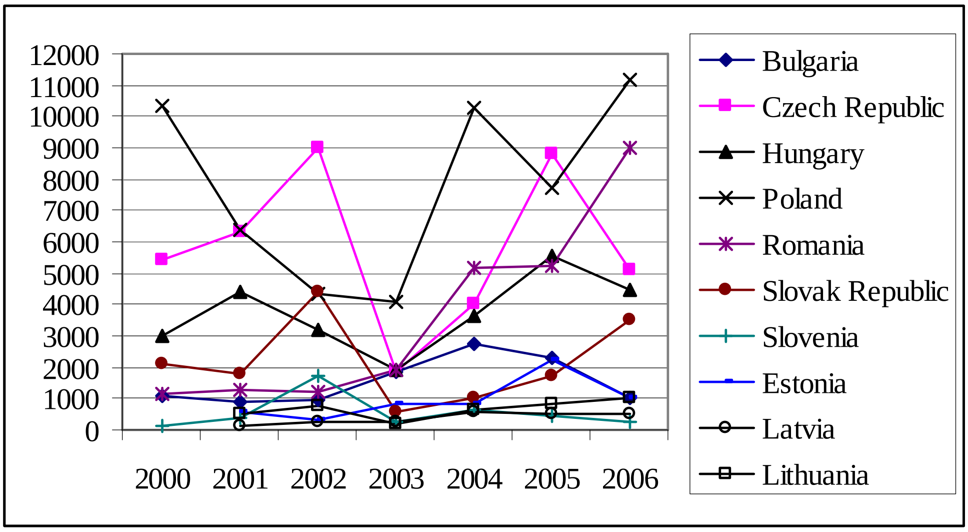
The accession to the European Union has been a major step towards anchoring the NMS-10 in the Union’s institutional framework, thus generally heightening investor confidence in the region (e.g. Havlik 2003). It is rather generally assumed that EU membership is an important background factor in FDI movement. Before 2004, foreign companies were said to prefer transitional economies with anticipated early EU entry. Now, after Eastern enlargement of EU, it is visible that NMS-10 -group has higher FDI figures (in relative terms) than other transitional economies. (Tiusanen 2006, p. 50) Thus, there has been a steadily accelerating inflow of foreign direct investment (FDI) into the CEEC region. The accession countries received about 63 % more FDI in 2006 than in 2001. The annual inflow increased from 22700 million euros in 2001 to 37100 million euros in 2006. (WIIW 2006)

“There is mounting evidence that enterprises with foreign investment participation are superior in terms of productivity, export performance, product quality and costs. In a few successfully restructured sectors (especially electrical, optical and transport equipment industries) where foreign investors have not only improved productivity, but also provided access to foreign markets, the cost benefits to the CEECs have been even greater than average – and are still improving.” (Havlik 2003, p. 13)

Owing to efficiency considerations, the multinational companies operating in the NMS-10 may even try to offset the effects of weaker global demand. Western European firms, but US, Japan, and Korean companies as well, are exploiting the NMS-10 cost advantages (and especially their cheap skilled labour) to an ever increasing decree. They are expanding production and increasing exports from these new locations, even when aggregate demand is low. They are also exploiting market growth possibilities in the financial and retail trade sectors. It was generally expected that EU enlargement would lead to additional FDI inflows to the CEECs – even after privatization is complete – since their attractiveness as productions sites would improve after accession, investment risks will decline and domestic markets grow. (Havlik 2003, p. 14)

The development of the FDI inflow per country in 2000-2006 is depicted in Figure 14. Poland received the largest annual inflow of FDI in 2006, followed by Romania, whereas Slovenia and Latvia received the smallest inflow. Foreign direct investments in Czech Republic have fluctuated profoundly over the period of 2000-2006. The increasing trend is most obvious in Romania which is largely based on increasing electronic industry investments there. Romanian cost levels are comparable to those in Asia (Majaniemi 2007a).

Figure 14. FDI inflow, mill. €.



Note: 2006 preliminary figures.
Source: WIIW

The major part of foreign direct investments in the CEECs from the EU15 appears to have been motivated by market access. Only a small part seems to be driven by low-wage costs. The lower risks associated to activities in the NMS-10 resulting from their EU membership of these countries is also important factor.

An important fact is also that investment in the CEECs is created rather than diverted from elsewhere in the EU. (Zuleeg 2002) FDI flows have been unevenly spread and originally driven by privatisation-related sales (Havlik 2003, p. 13).

According to the study by Kaitila et al. (2006, p. 54), the most important factors that have affected the Finnish companies FDI from the point of view of market expansion in the CEE4 countries have been growing markets, logistic location and the importance of being present on the market. These are followed by lover labour costs compared to Finland, company taxation in the target country and the enlargement of EU internal market to the CEE4 countries. Survey results of Teollisuus & Työnantajat (2004) support the fact that market potential and lower labour costs have been the driving forces of Finnish investments in the NMS-10.

Very similar results have been found in a study of the Polish market from the Finnish point of view (Kaitila et al. 2005). Both the studies confirm the view that Finnish companies operate in the new EU member countries in the Central Europe primarily not because of lower production costs but because of the local markets. The accession of the new member countries in 2004 was not expected to induce relocation of production from Finland to these countries. The pull effect of a more favourable level of production costs in these countries is not very strong in this respect. However, lower production costs do have a positive effect on FDI in general. Summary of the results is presented in Table 17.

Table 17. Factors affecting investment decisions in the CEE4 countries and Poland.

	CEE4 Mean*	Poland Mean**
Growing markets in target country	4.1	4.7
Growing markets in the other new member countries (excl. Poland)	-	4.0
Enlargement of EU internal market to the target countries	3.4	3.6
Logistic location compared to the company's other markets	3.8	3.8
Presence in the target country is important from the point of view of the firm's market expansion	3.8	4.1
Presence in the target country is important from the point of view of networking (and customer service in Poland)	3.6	3.0
(Lower) labour costs in the target country	3.6	3.8
Labour costs in Finland	-	3.0
Production costs in Finland	-	3.0
Other than labour costs in Finland	2.8	-
The price and availability of energy and raw materials in the target country	3.3	-
The price of energy and raw materials in Poland	-	2.8
The availability raw materials in Poland	-	2.8
Other production costs in the target country	3.6	3.1
Company taxation in the target country	3.3	2.7
Company taxation in Finland	2.9	-
Personal taxation in Poland	-	2.6
Availability of skilled labour in target country	3.4	-
Availability of (skilled) labour in Finland	2.9	2.4
Availability of labour in Poland	-	3.3
Customers of the acquired company at the time of the acquisition	3.7	2.9
Possession of the marketing channels and business skills of the acquired company in the target county	3.6	3.2
Acquisition of a competitor	3.5	2.2

* The scale used (1=very negative effect, 2= slightly negative effect, 3=no effect, 4=slightly positive effect and 5=very positive effect) is not really suitable for the calculation of the mean. The figures only give an idea of the magnitude of the effect.
** In order to facilitate comparisons the original scale of -2 to 2 is recalculated by author to correspond the scale of 1 to 5.
Source: Kaitila et al. (2006) and Kaitila et al. (2005).

The operations of Finnish industrial companies have been especially concentrated in Estonia, Poland and Hungary. Already in 1997 there was activity in Poland. The rapid entry into these countries was above all influenced by their economic policy in the 1990s. In the case of Estonia, its geographic location and cultural proximity had a great influence also. Poland was interesting especially from the point of view of the size of its market and location by Germany. Lately, activities have been expanding to Latvia, Lithuania and Czech Republic. (Teollisuus & Työnantajat, 2004)

Largest share of Finnish investment in the NMS-10 in 1998-2002 has been in technology industry as well as textile and clothing industry. On one hand, the investments in the textile and clothing industry have been concentrated merely in Estonia. On the other hand, investments in the technology industry are heavily concentrated in Hungary, where a substantial concentration of electronic industries has been formed. (Teollisuus & Työnantajat, 2004) The technology industry in Hungary is growing very fast also in terms of employment. For example, the total number if employees working in Finnish owned companies in that sector was 11800 at the beginning of 2007, with a growth of 3400 employees in 2006. (Lukkari 2007) In Hungary, about 7% of companies export 70% of Hungary's total exports. These are all foreign companies including Finnish Nokia. (Majaniemi 2007a)

Hungary also attracts foreign companies' service centres. Hungarian government started a programme at the beginning of the millennium to strengthen the country's reputation as a centre for technology industry and has also invested in education in this sector. The aim has been to build an image of an educated rather than cheap labour. (Majaniemi 2007d)

Recent news about the Finnish electronic industry and its foreign direct investments show that especially Romania has become a rival for Hungary in this sector. Cost effectiveness is a major reason for investment decisions. In Europe, the cost level in Romania is closest to that of Asia. For example Finnish companies Nokia and Elcotec have invested in production plants in Romania. (Majaniemi 2007a)

Elcotec is planning to keep its Estonian and Hungarian production approximately at its current level, whereas growth and competitiveness is looked for in Romania (Majaniemi 2007a). Also Nokia has a production plant in Hungary but market growth demands for further investments. Production in a new plant in Romania will be started at the end of 2007. This will mean that the production of Nokia's cheapest mobile phone models will gradually be produced in Romania instead of Hungary. (Majaniemi 2007b)

Also investments in construction industry in Poland have been large. Food industry expands rapidly to Estonia, but also to Latvia and Lithuania as well as in some extent to Poland. Forest sector investments are quite equally distributed between Czech Republic, Poland and Hungary. (Teollisuus & Työnantajat, 2004) For example, Finnish steel company Rautaruukki has production in Poland, Slovakia, and Hungary and is building a new plant in Romania. Growth potential and good logistic location in the Eastern Europe are important factors in their production. (Majaniemi 2007c)

According to a Finnish business survey (Teollisuus & Työnantajat 2004), the investments to the NMS-10 are expected to grow much faster than the total Finnish FDI. The estimated annual growth rate is over 4.5%. Growth is most pronounced in the Baltic States, especially Estonia and investments to Hungary also grow. On the other hand decreasing investments are expected in Poland, Czech Republic and Slovakia. Investments to the other NMS-10 were expected to remain at the present level according to the survey respondents.

The lower cost level in the NMS-10 also brings alternatives to the “China-phenomenon”. Geographically close location of “cheap production” supports activity also in Finland. This brings possibilities through vertical structuring of activities, where Finland is at the top of the value chain. At the same time as production in the NMS-10 has grown, the share of R&D personnel in Finland has increased substantially compared to the production personnel. (Teollisuus & Työnantajat 2004)

6 Conclusions

The impact of the enlargement has been difficult to estimate, especially since the distribution of effects between the old members and the new ones, and also the distribution within these groups, was likely to be uneven. The effects have also been likely to become more measurable in the medium term to long term, rather than immediately. Indeed the impact was estimated to be rather limited for the European Union in the first years after the accession, as the realization of growth effects also needs time. However, the psychological effects of dismantling the frontiers barriers may have had an even larger effect. Trade had been impacting the old EU countries and the Europe Agreements had helped EU business to expand their market already before the 2004 and 2007 enlargements. This had resulted generally in trade surplus of the old EU with the accession countries.

The largest enlargement impact in the EU15 is felt in the eastern border zone with the NMS-10, especially in Finland, Germany and Austria. It has to been born in mind though that the impact varies greatly across sectors also.

Bearing these limitations in mind, the current study relies heavily on survey results which reflect the subjective opinions and perceptions of the business community. How the enlargement impact has been felt in the companies’ practical operations and what have been their responses form the basis on the understanding of the total effects of the enlargements. It is only through the actual performance of the companies that the benefits or disadvantages realize. Statistics and other calculations concerning the various issues related to business environment in the enlarged unions complement the survey data.

Business community’s expectations in the old EU countries before the 2004 (and 2007) European Union eastern enlargement were not unanimous. Some industries expected more opportunities, some more threats arising from the enlargement. The situation was similar among individual enterprises. Some feared the potentially increasing competition up to the point that they were concerned about their own survival, while others saw a new era of market expansion.

Cost and price levels in the accession countries were on one hand feared to increase competition, but on the other hand offer opportunities through, for example, FDI in the new member countries. This was also expected to result in relocation of EU15 manufacturing industries to the new member states. Favourable cost levels in the NMS-10 have indeed been utilized especially by labour intensive industries. However, this has necessarily not resulted in relocation of the whole business to the new member states but restructuring of activities. Labour intensive business activities such as assembly have been located to the NMS-10 while for example the share R&D activity has increased in the home country.

To some extent, companies have been rethinking also their global location strategies. New member countries are seen as an alternative for China, for example. Production located in the NMS-10 is competitive with China in terms of productions costs and logistically location near the consumers and the growing markets in Europe provides an advantage in favour of the NMS-10.

Generally, the major expectations included increasing competition and at the same time opportunities related to larger European home market have been fulfilled. However, long term effects remain to be seen especially in the light of further enlargement of the European Union.

References

Alho, K., Hazley, C., Hernesniemi, H. & Widgrén, M. 2001b. EU:n itälaajenemisen vaikutukset Suomen tuotantorakenteeseen. ETLA, Elinkeinoelämän Tutkimuslaitos, Keskustelunaiheita, No. 752. 34 p. ISSN 0781-6847.

Alho, K., Kaitila, V., Kotilainen, M. 2004. EU:n laajenemisen vaikutukset suomalaisten yritysten strategioihin. Helsinki, ETLA, Elinkeinoelämän Tutkimuslaitos, Keskustelunaiheita, No. 885. 86 p. ISSN 0781-6847.

Alho, K., Kaitila, V & Widgrén, M. 2001. EU:n itälaajenemisen vaikutukset Suomen elinkeinoelämälle. The effects of EU Eastern Enlargement on Finnish Firms. (In Finnish with English summary). ETLA, Elinkeinoelämän Tutkimuslaitos, The Research Institute of the Finnish Economy. Series B 178. 187 p. ISBN 951-628-346-2.

Council of the European Union. 1997. Council Act 97/C 195/01 of 26 May 1997 drawing up, on the basis of Article K.3 (2) (c) of the Treaty on European Union, the Convention on the fight against corruption involving officials of the European Communities or officials of Member States of the European Union. Official Journal C 195 of 25 June 1997.

Council of the European Union. 2003. Council Framework Decision 2003/568/JHA of 22 July 2003 on combating corruption in the private sector. Official Journal L 192 of 31.07.2003.

Commission of the European Communities. 2005. Customs response to latest trends in counterfeiting and piracy. COM(2005) 479 final.

CSD Center for the Study of Democracy. 2007. The future of corruption benchmarking in the EU. Brief, February 2007, No. 11.

Eurobarometer. 2002a. Candidate countries Eurobarometer 2001.

Eurobarometer. 2002b. Public Opinion in the European Union. Report number 56.

Eurobarometer. 2003a. Public Opinion in the European Union. Report number 59.

Eurobarometer. 2003b. Eurobarometer 2003.3. Public Opinion in the Candidate Countries. Full Report 2003 Summer.

Eurobarometer. 2004a. Public Opinion in the European Union. Report number 61.

Eurobarometer. 2004b. Public Opinion in the European Union. Report number 60.

Eurobarometer. 2006. Public Opinion in the European Union. Report number 66. First results.

Eurobarometer. 2007. Public Opinion in the European Union. Report number 65.

Eurochambres. 2007. The business climate in Europe's regions in 2007. Economic survey 2007. European analysis 14th edition.

Eurochambres. 2004. The business climate in Europe's regions in 2004. Economic survey 2004. European analysis 11th edition.

European Commission. 2007. Combating counterfeit and piracy. A serious problem for everyone. http://ec.europa.eu/taxation_customs/customs/customs_controls/counterfeit_piracy/combating/index_en.htm

European Commission. 2005. Counterfeit statistics. http://ec.europa.eu/taxation_customs/resources/documents/customs/customs_controls/counterfeit_piracy/statistics/counterf_comm_2005_en.pdf

European Commission. 2004. Counterfeit statistics. http://ec.europa.eu/taxation_customs/resources/documents/customs/customs_controls/counterfeit_piracy/statistics/counterf_comm_2004_en.pdf

European Commission. 2003a. Counterfeit statistics. http://ec.europa.eu/taxation_customs/resources/documents/counterf_comm_2003_en.pdf

European Commission. 2003b. Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee - On a comprehensive EU policy against corruption. COM(2003) 317 final

European Commission. 1997. Results of the business survey. The Single Market Review. London: Kogan Page. Earthscan. 239 p. ISBN 0-7494-2344-7

Ferragina, A., Giovannetti, G. & Pastore, F. 2005. EU Actual and Potential Trade with Mediterranean and Central and Eastern European Countries. A Gravity Study. Economic Research Forum 12th Annual Conference, 19th-21st December 2005, Grand Hyatt, Cairo, Egypt.

Gligorov, V., Podkaminer, L. et al. 2007. Private Consumption and Flourishing Exports Keep the Region on High Growth Track. wiiw Research Reports 335. Special issue on economic prospects for Central, East and Southeast Europe.

Harris, P. R. 2001. Ensuring European leadership in the global marketplace. *European Business Review*, vol. 13, no. 6, pp. 336-345.

Havlik, P. 2003. EU enlargement: Implications for growth and competitiveness. A study commissioned by the Austrian Federal Ministry for Economy and Labour. The Vienna Institute for International Economic Studies (wiiw). 40 p.

Havlik, P. 2005.Structural Change, Productivity and Employment in the New EU Member States. The Vienna Institute for International Economic Studies (wiiw) Research Reports no. 313.

Kaitila, V. 1996. EMU yritysten näkökulmasta. EMU from the viewpoint of firms (in Finnish with English summary). Helsinki, ETLA, The Research Institute of the Finnish Economy. Series B 128. 225 p. ISSN 0356-7443.

Kaitila, V., Lindström, M., & Balcerowicz, E. 2005. Puolan liiketoimintaympäristö ja suomalaisten yritysten kokemukset. Helsinki: ETLA, Elinkeinoelämän Tutkimuslaitos, Keskusteluaiheita, No 994. 72 p. ISSN 0781-6847

Kaitila, V., Nikula, N., & Karsai, J. 2006. Suomalaiset yritykset Tsekin, Slovekian, Unkarin ja Slovanian markkinoilla. Helsinki: ETLA, Elinkeinoelämän Tutkimuslaitos, Keskusteluaiheita, No 1061. 86 p. ISSN 0781-6847

Lindström, M. 2003. Locational sources of competitiveness: Finnish companies' international business operations in the Baltic Sea region. ETLA, The Research Institute of the Finnish Economy. Series A 37. 179 p. ISBN 951-628-397-7.

Lukkari, J. 2007. Teknologiateollisuus palkkasi Kiinassa lähes 10000. Tekniikka&Talous, 26.4.2007. p. 5.

Majaniemi, R. 2007a. Halpa Romania vetää elektroniikkavalmistajia. Talouselämä 15/2007. pp. 64-67.

Majaniemi, R. 2007b. Nokian halpakännyköitä aletaan tehdä Romaniassa. Tekniikka&Talous, 19.4.2007. p. 10.

Majaniemi, R. 2007c. Rautaruukki hakeenyt kasvua Romaniasta. Tekniikka&Talous, 14.5.2007. p. 10.

Majaniemi, R. 2007d. Unkari kahmii jättiyritysten palvelukeskuksia. Tekniikka&Talous, 10.5.2007. p. 24.

Mirola, T. 2006. Impacts of the European Integration and the European Union Membership on Finnish Export Industries. Acta Universitatis Lappeenrantaensis 255. Diss. Lappeenranta University of Technology. 199 p.

Pirilä, H. 2002. Euroopan Unionin itälaajenemisen vaikutukset suomalaisiin pk-yrityksiin. Turun kauppakorkeakoulu, Yritystoiminnan tutkimus- ja koulutuskeskus Tutkimusraportteja B4. 130 p. ISBN 951-738-849-7.

Scadplus. 2007a. Combating counterfeiting and piracy in the single market. http://europa.eu/scadplus/leg/en/lvb/l26057.htm

Scadplus. 2007b.Customs response to latest trends in counterfeiting and piracy. http://europa.eu/scadplus/leg/en/lvb/l11016.htm

Staniland, M. 1997. Surviving the single market: Corporate dilemmas and strategies of European Airlines. *Journal of Air Transport Management*, Vol. 3, No. 4, pp. 197-210.

TED. 2007. Tenders Electronic Daily Archive. Available at: http://ted.europa.eu/

Tiusanen, T. 2003. Pan-European Integration. EU's Eastern Enlargement. Lappeenranta University of Technology, Northern Dimension Research Centre, Publication 1, NORDI series. 56 p. ISBN 951-764-805-7

Tiusanen, T. 2006. Transitional Economies and International Competitiveness. Lappeenranta University of Technology, Northern Dimension Research Centre, Publication 31, NORDI series. 53 p. ISBN 952-214-220-4.

Transparency International. 2006. Transparency International Corruption Perceptions Index 2006

Transparency International. 2005. Annual report.

Tuulenmäki, H. 1990. Pienten ja keskisuurten yritysten sopeutuminen Euroopan yhdentymiseen. Mikkeli: Helsingin kauppakorkeakoulu. Helsingin kauppakorkeakoulun julkaisuja. M-46. 97 p. ISBN 951-700-650-0.

Tuulenmäki, H. & Virtanen, M. 1990. Adaptation of Finnish small and medium-sized enterprises to the European integration. Discussion and working papers S-4, Helsinki school of economics and business administration. Small business center. 10 p. ISBN 951-702-148-8.

Van der Putten, R. 2002. The effects of EU enlargement on product and labour market. *Conjoncture*. July-August 2002. Available at: http://corp.bnpparibas.com/corporate-institutional-research-publications.

Widgrén, M. 2006. Trade potential in intra-industry trade and factor content of revealed comparative advantage in the Baltic Sea region. The Research Institute of the Finnish Economy ETLA, Discussion Papers No. 1034. 26 p.

WIIW. 2006. WIIW Database on Foreign Direct Investemnt in Central, East and Southeast Eurooe, 2006. Increasing Significance of Repatriated and Reinvested Earnings. Press Release 1.6.2006.

World Economic Forum. 2006. The Global Competitiveness Report 2006-2007.

Zuleeg, F. 2002. Benefits and threats of EU enlargement for Scotland. Scottish Executive Economist Group, Discussion Paper, No. 2. 25.p. Available at: http://www.scotland.gov.uk/library5/government/enlargement.pdf.

APPENDIX I

Previous research on the topic published by Lappeenranta University of Technology.

Available from 2003 onwards in pdf-format in http://www.lut.fi/nordi/publications/index.html

Authors	**Year**	**Title**	**Publication information**
Tiusanen, T.	2006	Transitional Economies and International competitiveness	Lappeenranta University of Technology, Northern Dimension Research Centre, Publication 31, NORDI series. 53 p.
Tiusanen, T.	2006	Foreign Investors in Transitional Economies: Cases in Manufacturing and Services	Lappeenranta University of Technology, Northern Dimension Research Centre, Publication 27, NORDI series. 61 p.
Tiusanen, T. & Kinnunen, J.	2005	EU’s Eastern Enlargement and the Future expansion of Eurozone	Lappeenranta University of Technology, Northern Dimension Research Centre, Publication 23, NORDI series. 54 p.
Tiusanen, T., Kinnunen, J. & Kallela, S.	2004	EU's Enlargement Process: Investment Climate in 10 Transitional Economies	Lappeenranta University of Technology, Northern Dimension Research Centre, Publication 7, NORDI series. 57 p.
Tiusanen, T.	2004	The Baltic States - Successful Transition in Estonia, Latvia and Lithuania	Lappeenranta University of Technology, Northern Dimension Research Centre, Publication 5, NORDI series. 40 p.
Tiusanen, T.	2004	Poland, the Largest New EU Country	Lappeenranta University of Technology, Northern Dimension Research Centre, Publication 4, NORDI series. 92 p.
Tiusanen, T.	2003	Pan-European Integration. EU's eastern enlargement.	Lappeenranta University of Technology, Northern Dimension Research Centre, Publication 1, NORDI series. 56 p.
Tiusanen, T. & Kellens, S.	2000	Poland in the 21st century: Western companies in a successful transitional economy	Lappeenranta University of Technology, Studies in industrial engineering and management. 96 p. Rev. ed. of: Poland in the 1990’s, business opportunities in a successful transitional economy, 1st ed. 1997
Tiusanen, T. & Vinni, S.	1999	Hungary in the 1990’s: business opportunities in a successful transitional economy	Lappeenranta University of Technology, Studies in industrial engineering and management No 7. 131 p.
Tiusanen, T. & Vinni, S.	1999	Bulgaria, Romania, Slovakia and Slovenia in the 1990’s : investment opportunities in transitional economies	Lappeenranta University of Technology, Studies in industrial engineering and management No 8. 142 p.

Tiusanen, T. & Talvitie, K.	1998	The Baltic states in the 1990's : Western companies in Estonia, Latvia and Lithuania	Lappeenranta University of Technology, Studies in industrial engineering and management No 4. 144 p.
Tiusanen, T. & Talvitie, K.	1997	The Czech republic : business opportunities in a successful transitional economy	Lappeenranta University of Technology, Studies in industrial engineering and management No 2. 160 p.
Tiusanen, T.	1997	Poland in the 1990's: business opportunities in a successful transitional economy	Lappeenranta University of Technology, Studies in industrial engineering and management No 1. 108 p.