Michael C Bonello: Regional economic integration - the options for Malta

Speech by Mr Michael C Bonello, Governor of the Central Bank of Malta, at the Annual Dinner of the Institute of Financial Services, St. Julian's, 7 November 2002.

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In previous years I used this occasion to focus on issues related to the country's perennial challenge, which is to converge to the economic standards of its more developed trading partners. Among the appropriate responses to this challenge I emphasised the importance of price and financial stability, fiscal restraint, market-based reforms and a viable exchange rate strategy. These are indeed necessary elements of a strong macroeconomic policy framework conducive to export-led growth. The issue I shall address today is the need to complement these policies with a more secure access to international markets. The reason is simple. Without such access, a small open economy like ours cannot hope to achieve sustained, quality growth in today's globalized world.

A structured, regional approach to building competitiveness

In a world economy driven by cross-border flows of foreign direct investment (FDI) seeking the most profitable locations, the challenge of sustaining economic growth must be faced head on by endeavouring to maintain cost competitiveness and gaining access to larger markets. Studies have shown that countries which are more open to trade tend to achieve higher growth rates compared to less open economies at comparable stages of development.[1] Of course, openness also brings with it greater exposure to external shocks, particularly for small economies that cannot aspire to any degree of self-sufficiency.

Experience, however, suggests that such exposure does not necessarily translate into vulnerability for small economies if they are closely integrated with larger ones. For example, the greater resilience of countries in Central and Eastern Europe over that of a number of other transition economies has been attributed to the relatively stronger trade links which the former have with rich, neighbouring countries.[2] In addition, the latest IMF *World Economic Outlook* shows that over the past 25 years less integrated economies exhibited a higher degree of susceptibility to financial crises than economies with strong trade linkages, and that financially integrated economies in turn experienced a lower degree of output volatility than those with closed financial markets.[3] This suggests that trade and financial integration with major trading partners remains a preferred option.

This conclusion is borne out by the experiences of small states such as Luxembourg and Singapore. The fundamental characteristics of these countries resemble Malta's in that they too are small open economies which lack natural resources. Both, however, have achieved far higher levels of prosperity.[4] Luxembourg, for example, with a population only slightly larger than that of Malta has a per capita income three times higher. This success is attributed to Luxembourg's ability to reap economies of scale by integrating with larger, prosperous territories in a way that has permitted high-value, export-oriented firms to flourish alongside domestically-oriented ones. In addition, by pooling resources with those available in neighbouring countries, Luxembourg has managed to address resource limitations and other problems that it could not deal with in an effective way on its

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1 Excluding OECD member states and a number of countries that are well known for their pro-trade orientation, Dollar and Kray (2001) find that developing countries who had the largest trade to GDP ratios also experienced the highest per capita growth rates since the 1960s. They note, for example, that these countries - which they term the "post-1980 globalizers" - have seen their average annual growth rates jump from 2.9% in the 1970s and 3.5% in the 1980s to 5.0% in the 1990s. By contrast, the non-globalizers have seen their growth rates fall from 3.3% in the 1970s to 1.4% during the 1990s. Dollar., E. & A. Kray. (2001) Trade, Growth and Poverty. World Bank, Policy Research Department, Working Paper No. 2615. USA, Washington.

2 "The Challenge to Small, Landlocked Transition Economies - Trends and Policies in the World Economy", in World Economic and Social Survey 2001, Department of Economic and Social Affairs, United Nations.

3 "Consequences of Trade and Financial Integration for Macroeconomic Volatility", in IMF, World Economic Outlook 2002.

4 While Malta ranks 50th in terms of income per capita, these countries are among the 20 richest economies of the world. World Development Indicators 2002. World Bank.

own. Similarly, Singapore has developed into a regional hub by supplying manufacturers and service providers in booming Southeast Asian economies. And not only does it participate in the Association of South East Asian Nations, but it also has a far reaching trade agreement with New Zealand, which is expected to develop into a closer economic partnership that will in time also include Hong Kong and Japan.[5]

These countries are not unique in this regard. Recognising that success in world markets requires a critical mass in order to foster competition and competitiveness and to acquire a measure of bargaining power, countries the world over are turning to regional arrangements as a stepping stone to gaining a foothold in the global economy.[6] They know that belonging to a regional grouping also makes it easier to attract FDI and to absorb the necessary technology and management expertise that can be applied elsewhere in the economy. Such arrangements also provide members with a first-hand experience of the negotiation process. The World Trade Organisation estimates that 243 regional trade agreements are in force today,[7] covering at least 129 countries.[8] Regional groupings moreover are not only increasing in number, but they are also becoming deeper in scope, encompassing areas of policy other than trade and investment.[9]

This brings me to the first point I wish to make today. The experience of other countries shows that the capacity necessary to deal with the competitive forces of globalisation can be optimally built in stages through participation in regional arrangements. The implication is that in order to reap the full benefits of the policy reforms currently under way, Malta does not only need to integrate further internationally, but has to do so through a structured approach that seeks to exploit potential synergies with other economies. The question then arises, "What kind of regional arrangement and with whom?".

Malta's potential partners for regional integration

Traditionally, partners to regional integration arrangements exhibit strong trade ties based on complementarity in terms of resource endowments and geographical proximity, as well as a common historical and cultural background. These criteria limit the scope for integration between Malta and a number of outlying European countries such as the transition economies of Eastern Europe and the EFTA countries. In fact, Malta's commercial links with these countries are weak, with only a few economic sectors that could be of potential interest to both parties. In 2001 Malta's exports to EFTA countries represented less than 0.5% of its exports to the European Union (EU). It follows that the EU and the countries of North Africa, many of which are participating in the Euro-Mediterranean Partnership known as the Barcelona process, are more likely to be potentially viable regional partners for Malta.

As far as the latter countries are concerned, there is no doubt that they have made considerable progress in recent years. Most of them, however, require more time to be able to take full advantage of their potential. A strategy based solely on closer ties with these countries, therefore, would tend to condition Malta's development to proceed at a slower pace than its own potential would justify. Furthermore, although efforts are being made to create a Euro-Mediterranean free trade area (FTA) by 2010, this date appears rather optimistic. This was confirmed by the Spanish Presidency last March, which noted that a critical mass of implemented FTAs between the partners themselves has yet to be

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5 Singapore has recently also initialled a bilateral agreement with Japan.

6 Indeed, these are the precise reasons put forward by the Minister of Industry and Trade of the Republic of Tanzania during the 47th session of UNCTAD's Trade and Development Board where he noted that:

"We do not believe that we can enter into the international arena under today's rules if we do not go through these steps at regional level".

7 Of these arrangements only 141 have been notified to the WTO. "Regional Trade Integration Under Transformation", WTO Secretariat, 2002, preliminary draft prepared for the Seminar on Regionalism and the WTO on 26 April 2002

8 These include members of AFTA, the Andean Community, CARICOM, COMESA, ECOWAS, the EU, MERCOSUR, NAFTA, SADC, CACM, LAIA, ECO, GCC and the Bangkok Agreement. This does not include countries which have stand-alone FTAs/Association Agreements with another country or regional grouping.

9 The ANDEAN Pact, for example, also deals with biodiversity, electronic commerce and the protection of indigenous knowledge.

reached.[10] Finally, it is also to be noted that an essential aspect of an eventual Euro-Mediterranean FTA is expected to be an obligation to achieve equivalence in standards.

At this stage, therefore, a growth strategy that relies on closer links with these countries appears neither plausible nor likely to provide adequate opportunities in terms of market access. The only viable alternative thus seems to be to forge stronger ties with the EU, with whom Malta is already closely integrated through trade and investment. The EU accounts for more than half of Malta's trade in goods and for around 80% of incoming tourists.[11] The EU is equally important as a source of FDI, accounting for some 43% of the total in 2000.[12] This suggests that strengthening the existing relationship with the EU is more likely to produce early results than attempting to develop ties with other regions starting from a very small base.

Malta's relationship with the EU - alternative scenarios

Malta could, for example, retain, or attempt to upgrade, the existing Association Agreement. As it stands, this agreement is very narrow in scope, focusing on industrial goods to the exclusion of most agricultural products. In addition, it is severely limited by a set of rules of origin whereby local exports only benefit from preferential access to the EU market if the percentage of the value of the product that originates in Malta exceeds a minimum threshold. If this agreement is to be upgraded, however, Malta would have to make commitments over and above those it has today. Indeed, many of the countries with whom the EU has a comparable agreement have managed to obtain a better deal than Malta not only because they are much larger in terms of market size, but also because they have entered into additional commitments. EEA countries, for example, do indeed participate in EU programmes, but they have also offered substantial rebates on loan-related interest payments and committed nearly ECU 500 million in direct grants for projects in specific EU regions. In other words, EEA countries contributed to the EU's financial resources, and specifically to the EU's regional policy, without being members of the EU. In addition, it is well known that membership of the EEA implies taking on a large part of the EU acquis, whether past, present or future, without having any say in the decision-making process.

Nor is the obligation to come into line with the acquis unique to the EEA. As is the case with Switzerland, which is an EFTA but not an EEA country, the EU's trading partners are increasingly being required to approximate their national laws with those of the EU as a precondition for access to its market[13].

The second conclusion to emerge from this analysis, therefore, is that if Malta seeks to negotiate a more advantageous form of association agreement, our exporters will only be able to secure improved access to the EU and its partners if the Maltese Government makes commitments in areas other than those covered by the present agreement, including a commitment to achieve legal equivalence with the EU Acquis.

Pressures to liberalise, the costs of restructuring and the obligation of legal equivalence will arise irrespective of EU membership

It could be argued that as a non-member the pace with which this legal equivalence would have to be achieved would be slower than that implied by the current enlargement calendar. In practice, however, the difference in timing is subtle. It must not be forgotten that nine other countries are also about to

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[10] In addition, a recent study by the World Trade Organisation shows that this is one of the regions with the lowest concentration of regional trade arrangements, a situation which is not expected to change much in the medium-term. See footnote 7 for source.

[11] NSO, News Release 103/2002.

[12] NSO, unpublished estimates

[13] During the Euro-Mediterranean Ministerial Conference on Trade held in March 2002, participating Ministers noted that the dismantling of tariffs will not be enough:

"Businesses have to benefit from an economic environment where trade is facilitated by an adaptation and a harmonisation of regulatory provisions concerning the free movement of goods, standards, right of establishment, property rights."

join, which means that they will shortly have complete access not only to an enlarged EU market, but also to the reciprocal trade agreements which the EU has with third countries. If local businesses are not to lose out to competition from this new source, therefore, the administrative burdens and financial outlays associated with the achievement of legal equivalence and the adoption of EU technical standards will have to be borne within the same time frame available to the other candidate countries, irrespective of whether Malta joins the EU or not.

Yet even if such compliance is achieved on schedule, under any arrangement other than membership Malta would only be able to tap the markets covered by EU reciprocal agreements by negotiating individual bilateral agreements with most of the countries in question. Given Malta's limited negotiating capacity, combined with the slow pace with which the conclusion of such agreements tends to proceed and also the high degree of protection in many developing countries, this seems to be an unrealistic objective.

This at a time when Malta has already started to graduate from the General System of Preferences (GSP) through which some developed countries grant non-reciprocal preferential trade access to less developing countries. For example, Malta graduated from the GSP scheme of the USA at the end of last year. In addition, pressures are mounting on developed countries in the WTO to extend any preferential treatment accorded to a subset of WTO members to all other members, such that any preferential treatment given to Malta by any country over and above that accorded to other WTO members will be lost in any case.

In a non-membership scenario, moreover, the EU-Malta income gap would tend to widen because the other new members will continue with reforms that are conducive to attracting FDI. Indeed a recent study shows that the EU decision to open negotiations with the first-wave of accession countries had by itself reinforced FDI flows into these countries. This has implications for the catching-up process, because countries that absorb the highest amounts of FDI normally continue to attract the bulk of new investment in later years.[14] So that if the scale of FDI flows into Malta fails to keep up with that going to the other candidate countries, Malta could easily fall behind these countries in terms of GDP growth and living standards. This at a time when the CEECs already absorb around 33% of all FDI flows from the EU to emerging markets, and when this region is increasingly becoming the dominant sphere of EU investors.[15] It is, therefore, of paramount importance that the pace of reform be accelerated, irrespectively of whether Malta joins the EU or not.[16]

Against this background, it appears that securing access to the EU market will become increasingly difficult as a non-member. Membership, on the other hand, promises immediate benefits for local exporters, because any product made in Malta would not only have complete access to the EU, but would also benefit from any preferential treatment which the EU receives under the various reciprocal trade agreements it has with third countries, without the need for Malta to negotiate separate agreements and without being subject to country of origin limitations. The extent of this benefit could be substantial because the EU does not merely have reciprocal trade agreements with Northern and Eastern European countries and with its Southern Mediterranean partners, but has also finalised, or is close to finalising, similar agreements with more distant countries and regional blocs, including Mexico, South Africa, Chile, Mercosur[17] and the Gulf Co-operation Council[18]. For many local firms EU membership would also translate into an opportunity to outsource inputs more cheaply, and for consumers a wider choice and cheaper products.

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14 This follows from the fact that transnational corporations often react to the prospect of a larger market arising from regional arrangements by establishing integrated production and distribution networks within the region in question.

15 Eurostat, European Union Foreign Direct Investment Yearbook 2000. Moreover, according to UNCTAD's latest World Investment Report, Poland, the Czech Republic, the Russian Federation, Hungary and Slovakia absorbed around seventy-five per cent of world FDI flows to Eastern Europe in 2001.

16 Staying out of the EU is also likely to have negative implications for Malta's credit rating. In a recent report, for example, FITCH credit rating agency notes that:

"staying out would damage Malta's creditworthiness unless a new government were clearly determined to retain and develop the parts of the EU Acquis that are starting to enhance the efficiency and competitiveness of the Maltese economy."

17 Argentina, Brazil, Paraguay and Uruguay.

18 Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates

EU membership would also pose some challenges. For example, because membership implies more than a free trade agreement, Malta would have to apply the EU's common external tariff (CET) to imports from third countries. Upon closer examination, however, it seems that this is unlikely to be a major problem. For a start, Malta's customs duties on non-EU imports are already roughly in line with the CET, so that not much change would be necessary. Furthermore, the CET is foregone in the case of all those non-EU countries which benefit from preferential access of the EU market, especially in the case of raw materials. This means that imports can be purchased from alternative sources, possibly from the enlarged EU market, or from non-EU countries which enjoy access to the EU market. Finally, the CET is also suspended when the imported raw material is re-exported outside the EU as a finished product[19]. So while the costs of production for some sectors of the economy may increase, and this in turn could have implications for inflation, at least in the short-run, this impact is likely to be minimal in practice.

As a member Malta would also assume the EU's commitments under the non-reciprocal agreements with developing countries. Whereas this could have negative implications for specific sectors, for the economy as a whole these effects are unlikely to be significant or enduring. This is because the proportion of imports from these countries in Malta's import bill is marginal. Second, the Cotonou Agreement, which is the EU's most relevant agreement in this regard, will expire in 2008, by which time it is expected to be superseded by Economic Partnership Agreements based on reciprocity.[20] If anything, therefore, the EU network of reciprocal trade agreements will increase. Within a few years importers and consumers should thus have more and not less access to duty-free imports, and any short-run increases in inflation should be more than neutralised. Third, the opportunity cost of staying out of the EU will increase for export-oriented firms.[21] And finally, since the ACP (African, Caribbean and Pacific) countries that are parties to the Cotonou Agreement are an important source of raw materials for the EU itself, the duty-free access of their raw materials should actually benefit Malta which imports all its raw material needs.

In the process local firms would, of course, also become subject to competition from countries covered by reciprocal trade agreements with the EU, and inefficient and high-cost producers in Malta could well be driven out of the market. To a great extent, however, this adjustment is already taking place, not least because the removal of import levies is well underway. Thus, while there could be some increased costs, the effects on unemployment should be limited. In any case, both the Government and the EU have mechanisms designed to assist uncompetitive firms. It could also be argued that some job losses are inevitable if we really want to give consumers a better deal while promoting the competitiveness of domestic firms.

A short-term increase in unemployment, moreover, could well be reversed. This is not an unrealistic expectation. Investors from non-EU countries will find that they would be in a better position to tap the enlarged EU market by consolidating their activities in the new members than by accessing these markets separately. The opportunities which enlargement would provide for investors should not be underestimated given that Europe is the region having the greatest concentration of regional trade agreements with third countries, and that it is also the region with the highest proportion of imports that is outsourced from partners covered by such agreements. The resultant increase in employment opportunities should compensate for any jobs lost through restructuring.

The prospect of access to a large market will not, of course, alone guarantee larger inflows of FDI. Investment decisions are not based solely on considerations of market size. Unfortunately, Malta is at a disadvantage in terms of other relevant criteria such as resource endowments and transport costs. Such deficiencies, therefore, have to be made up for through other factors, including a sound

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[19] It could also be argued that the additional tax revenue from the application of the CET to imports from non-EU countries would make up at least partly for any losses arising from the removal of duties on intra-EU trade and trade with EU partners covered by reciprocal agreements.

[20] The Cotonou Agreement additionally foresees that the number of developing countries that will continue to receive non-reciprocal access to EU markets under other agreements of this type is expected to decline, although there could remain a certain degree of asymmetry in timing to take into account the specific needs of developing countries.

[21] It is also relevant to mention that although Malta does not benefit directly from the pre-accession funds which are available to the other accession countries of Eastern Europe, Maltese companies may already bid for contracts awarded to projects financed under one of the funds in question. (Instrument for Structural Policy for Pre-accession) The benefit would probably be lost under a looser form of agreement with the EU.

macroeconomic framework, political stability, high productivity levels, a transparent and simplified regulatory framework, and an assurance that business and productive activities are conducted in line with internationally accepted standards. This would, of course, hold true whether Malta joins the EU or not.

Costs of participation in international fora obviated by EU membership

While EU membership also entails the administrative burdens associated with participation in EU institutions, it should at the same time help to strengthen Malta's presence in international fora. As Malta does not have the capacity to be present in every forum, it would be in a stronger position as a member of a large block. One could, of course, argue that this would also be achieved in other scenarios. Experience suggests otherwise however. For example, despite the efforts made to create a coalition of small states in the decision-making bodies of organisations such as the World Trade Organisation, the International Monetary Fund and the World Bank, and despite the fact that the specific problems of small states are universally recognised, these efforts have proved largely futile. The situation is not expected to change in the near future in view of the differences among small states themselves.[22] As an EU member, moreover, since Malta's representation in EU decision-making bodies would be more than proportionate to its population, its voice would stand a better chance of being heard, not least because most of the other acceding countries are also small and could be potential allies on issues of common concern.

Indeed as Malta's recent experience with the OECD and developments relating to the proposed EU savings tax directive have shown, Malta is likely to obtain a better deal as an EU member. Four years ago the OECD was planning to take action against non-co-operative countries on its list of "harmful tax havens". Malta was not on the list because the Maltese Government undertook to eliminate any offending practices and to exchange information with foreign tax authorities once a level playing field was achieved. But the relevant aspect of this episode is that small jurisdictions are being compelled to revisit their strategies and diversify their economies in a manner which does not harm the interests of stronger, high-tax economies, and that standards and codes of good practice will increasingly serve as another dimension of competition.

In these circumstances it cannot but be perceived as an advantage by prospective members that the EU not only has the capacity to resist threats to the competitiveness of its members, but also has enough bargaining power to persuade its competitors to reach a compromise acceptable to its members.

The EU, for example, is putting pressure on Switzerland and the United States to adopt equivalent measures to those contained in the proposed EU directive on savings taxation. It has gone as far as to suggest that it could impose sanctions and even hold up negotiations in other areas if Switzerland remains opposed to a deal on the exchange of information on the savings of EU citizens with Swiss banks. This stance is quite credible given that Austria, Belgium and Luxembourg have a vested interest in this matter and have declared that they will only support the new package if Switzerland, the United States and other third countries[23] agree to apply equivalent measures. As a matter of fact, since this package is a tax-related measure it can only be adopted on the basis of unanimity, which means that it cannot be approved without the support of countries such as Luxembourg.

From the perspective of the current debate in Malta, the ongoing negotiations between the EU Commission and Switzerland do more than raise questions about the durability of bank secrecy regimes. More relevantly they cast doubt on the assumption that third countries are able to protect their immunity from EU decisions simply by virtue of their status as non-members. The savings tax example also shows that even a small country like Luxembourg can, through its membership in the

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[22] Guinea-Bissau, for example, has a GNP per capita of only $160, whereas countries such as Brunei, Cyprus, Malta and Qatar have a GNP per capita of more than $9,000.

[23] These include Andorra, Liechtenstein, Monaco and San Marino. The US is trying to resist the move. In July 2002 the Treasury Department in fact withdrew a draft law which would have made it compulsory for American financial bodies to provide extensive information on savings income invested in the United States by non-residents and replaced it with a less onerous law that limits the extent of information and the number of countries to which it would apply.

EU, succeed in getting a larger country to give up some of the competitive edge it enjoys in a particular sector.

It is to be expected that similar manoeuvres will become more frequent in an enlarged EU. Having a voice in setting the rules would then assume paramount importance, especially since the other new members, who are Malta's competitors in several areas, would themselves be seeking to advance their own interests. This, in turn, also casts doubt on whether Malta would be able to obtain transitional arrangements and derogations comparable to those it has obtained thus far if it had to negotiate with the EU when Bulgaria, Romania and Turkey have become members.

This leads to my third conclusion. If, irrespective of whether and when Malta joins the EU, local producers and service providers will continue to be influenced by decisions taken by the EU, and given that the other channels through which Malta could possibly gain a better representation in international fora are not well-developed, Malta would probably be in a stronger bargaining position as an EU member.

The macroeconomic discipline aspect of EU membership

As in any other club, EU membership and access to the privileges associated with it entails an obligation to contribute to the common budget. Now the debate on whether to join the EU has so far focused almost exclusively on whether Malta would be a net contributor or recipient of EU funding.[24] A decision having such momentous implications cannot, however, be based only on issues relating to post-accession funding, which is a time-bound mechanism designed to help lagging EU regions catch up with the more affluent ones. For apart from broader geo-political and social considerations, EU membership represents a concrete, long-term response to the challenge of developing a modern economy with the capacity to generate wealth in a sustainable manner. In the case of Ireland, Portugal, Spain and Greece, the EU has indeed proved to be a most effective mechanism for this purpose.

This is so because the EU is unique among other regional arrangements in that it goes beyond market liberalisation and the harmonisation of standards, and encompasses more fundamental aspects of integration. For this audience of bankers and financiers, it would be appropriate to illustrate this point by reference to the institutional framework governing macroeconomic policy in the euro area.

Although new members cannot join the euro area immediately upon accession, they are expected to participate in EMU eventually and, therefore, to show a commitment to a stable macroeconomic framework even before accession. Whatever the outcome of the current debate about the Stability and Growth Pact, fiscal discipline will continue to be an important policy ingredient of such a framework as it is a necessary condition for the success of any monetary union. In addition, the obligation to fulfil the Maastricht criteria provides members of the euro area with the impetus to safeguard the sustainability of their economies, not least because deficiencies in the real sector of the economy would ultimately weaken the ability of a Member State to fulfil the Maastricht criteria on an ongoing basis.

The euro adds an important dimension to these disciplines. First, through its effects on price transparency it will increasingly compel dominant players in the market place to reconsider their behaviour. This also applies to the financial sector, because a growing number of savers and borrowers will be offered a larger selection of euro-denominated financial instruments that will in time be tradable without limitation across the EU. This will have the added advantage of causing interest rates to converge to low levels.

In addition, although the EU has not yet reached all the objectives of the 1999 Financial Services Action Plan, there is evidence that they will be met on schedule, not least because the euro will provide the market with the necessary impetus to identify the remaining obstacles to the completion of the single market. A clear example of this is provided by the regulation on cross-border payments in euro which seeks to eliminate unjustifiable differences between charges on cross-border transfers and

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[24] On the same reasoning Malta should withdraw from international financial institutions such as the World Bank and the European Bank for Reconstruction and Development since it is no longer entitled to financing from these institutions. This, however, has not occurred because it is recognised that membership in these institutions yields more than monetary benefits.

those on transfers within Member States. Another consists of the initiatives underway to extend the single passport beyond the banking sector to investment services, insurance intermediaries and securities markets. This will have at least two implications.

First, a financial product licensed in one Member State would automatically be recognised in all others without the need for the service provider to go through licensing and listing procedures afresh. For financial service providers this is an opportunity to by-pass the regulatory and other barriers that would otherwise render them uncompetitive. For the individual Member State, this is an opportunity to attract financial service providers from third countries who want to take advantage of the opportunity to establish themselves and market their products anywhere in the EU. Second, the single passport will also reduce the cost of doing business. It is in fact estimated that the Action Plan would reduce the cost of capital for 18 million businesses in the EU and drive down the cost of financial services for consumers.

Conclusion

Against this background it is not surprising that studies on the effects of enlargement show that growth rates would be higher under EU membership than under any other scenario. A European Commission study shows, for example, that during the first five years following accession, growth rates in the acceding countries would be between 1.7% and 3.2% above those that would be achieved if these countries were to proceed with current reforms without joining the EU.[25] A comparable finding also emerges for Malta: the annual growth rate would be between 1.7% and 1.9% higher in the short-run than it would be under the non-membership scenario. The difference would be even larger in subsequent years – Malta's growth rates could then be between 4.4% and 6.1% higher under EU membership.

Such findings and related considerations have led governments, political parties, trade unions and academics from twelve European countries, large and small, islands and continental ones, to conclude that membership of the EU is on balance the best available response to the challenges posed by globalization. Those who perceive EU membership as a unique opportunity are equally aware that catching up with some of the most economically and socially advanced countries on earth is a major task for countries whose average income is still only some 40 per cent of the EU average. This challenge can only be overcome if the candidate countries seriously question the way they have organized and managed their economies in the past, and resolve to raise their performance. The magnitude of the task is not to be underestimated because the necessary changes are pervasive – affecting both institutions and mindsets, policies and work practices – and they also entail costs, financial and otherwise.

There is clearly, however, also a widespread conviction in the other candidate countries that this would be change with a purpose. Apart from the highly desirable prospect of convergence with EU income levels and living standards, a process itself facilitated by EU financial and technical assistance, the pay-off would include anchoring the future prospects of each new member country to those of an economic superpower, unfettered access to a large and rich market with a single currency, the adoption across the board of international best practices and standards and, not least, a place at the table where decisions are taken which would affect these countries even as non-members.

The dynamics of regional economic integration are such that the choices available to our policymakers will be inevitably conditioned in future by the policies of an enlarged and stronger EU. It should, therefore, be clear that if it is to prosper, Malta will have to seek an accommodation with the EU. The prevailing view among countries on the periphery of the existing EU-15 is that the prospective long-term benefits of membership outweigh the costs. That is why they are anxious to become members.

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[25] European Commission, Directorate General for Economic and Financial Affairs. (2001) "The Economic Impact of Enlargement." Enlargement Papers No 4. June. http://europa.eu.int/economy_finance. The report notes that between 2005 and 2009 the average growth rate in 8 of the accession countries (the first wave of exceeding countries excluding Malta and Cyprus) will be 2.9%, 4.6% and 6.1%, respectively under the baseline scenario, a central scenario and an optimistic scenario. In a similar vein, a recent report by the National Bank of Hungary concludes that the adoption of the euro could boost economic growth in Hungary by between 0.6 to 0.9 percentage points annually for 20 years. Most of the growth will come from increased international trade. See National Bank of Hungary, Occasional Paper 24, "Adopting the Euro in Hungary: expected costs, benefits and timing", by Attila Csajbok and Agnes Csermely.

Until such time as an equally well-documented argument is made which seriously questions this view, the case for membership remains a compelling one.