Renata Stawarska[*]

Economics of the EU Enlargement: the Positive Case

> *"Both Western and Eastern Europe are thus going through experiences of sharp transition, at the macro level of the restructuring of the political economy and at the micro level of adjustment. One key issue is whether these differently derived processes of transition in the two parts of Europe are complementary or in tension".*[1]

The integration of the countries of Eastern and Central Europe into the European Union through the so called Europe Agreements (a new generation of association agreements) proceeds along a line parallel to their processes of systemic transformation. The two processes are closely interrelated in terms of their scope and the pace of their implementation. There is a strong link between the regulatory environment and the actual developments. All in the meanwhile, the poorly developed institutional infrastructures and the insufficiently competitive economies of Central and Eastern Europe are being forced into premature openness and liberalisation, while being subjected to the overly strict requirements imposed upon them in compliance with Western norms and standards (also in the area of social life). This may prove more damaging than beneficial in the short term.[2] In order to prevent disaster, certain transitional solutions must be developed to ensure a gradual reconciliation of the two following factors: an appropriate rate of adjustment to the *acquis* on the one hand, and the sustaining the GDP growth rate already achieved by the candidates to accession, on the other.

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[*] Dr **Renata Stawarska**: Deputy President of PECSA, Director of Centre for Documentation and Research on the European Communities, University of Economics in Poznań.

[1] H.Walace, *Coming to Terms with a Larger Europe: Options for Economic Integration,* Sussex European Institute, Working Paper, no. 23 1998.

[2] According to A.Mayhew, at a conference at the College of Europe on "Political Economy of EU Eastern Enlargement", June 28-29, 1997, the Polish Labour Code is much more demanding than the European Union labour law.

It is necessary to create a long-term vision of economic growth and cultural advancement, a vision that would ease the growing pains of adjustment, often felt very acutely and spread unevenly throughout society. Dynamic growth may also limit the burdens of adjustment to a minimum.

The enthusiasm for the idea of integration expressed by the populations of the countries aspiring to join the European Union, including Poland, stems not only from the prospect of improving their standard of living, but also from hopes for enhanced security structures needed in the difficult geo-political position of the aspiring nations. Another important reason is their desire to rejoin the "European Club" to which the Eastern and Central European countries have belonged for centuries through religious organisations, cultural links and royal/family ties.

The author of this paper is an economist who remembers Jean Monnet saying that a unified Europe can be more than a Europe of merchants. I would like to demonstrate how views in this area have evolved. Changes in the nature of political views may come when politicians become better informed, but they may also serve as a ploy designed to cater to the expectations of voters. I am confident that this paper will serve to promote the former rather than the latter.

1. Europe Agreements: the legal base of EU relations with CEEC (Central and Eastern European Countries)

The Europe Agreements signed by the European Union and the candidates for membership constitute a new generation of association agreements. Their purpose is to establish FTAs (Free Trade Areas) within 10 years of their coming into effect. Their scope and significance, however, go beyond the parameters of a purely commercial deal. The agreements oblige the signatory parties to engage in political dialogue, to approximate legislation and gradually to move towards the introduction of the *acquis communautaire* (e.g. in the area of the Internal Market). The agreements specify the principles, which are to govern the gradual liberalisation of service transfers and the related rights of establishment as well as the currently very restrictive laws regulating the transfer of service providers. The Europe Agreement also contains a chapter on financial assistance and one on institutions established by the signatory parties to ensure a smooth transition to the EU and to supervise the process. The institutions include the Association Council, the Association Committee and the Parliamentary Association Committee.

Ten Eastern and Central European countries have signed the European Agreements with the EU. Among these are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. All of them applied for membership between 1994 and 1996. Also "knocking on the European

Union's door" is Cyprus, which concluded its association agreement on June 1, 1973, and applied for membership on July 4, 1990.

Of all the candidates the ones to start accession negotiations first are Estonia, Poland, Czech Republic, Hungary, Slovenia, and Cyprus.[3]

The Europe Agreement falls short of instituting the four freedoms, although it does mention them. The free movement of services, labour and capital still remains a point extensively discussed in membership negotiations. The free trade agreement is where the integration ambitions of the CEECs have gained the most ground. As for Poland, whose Interim Agreement (the trade section of the Europe Agreement) came into effect on March 1, 1992, the free movement of industrial goods was introduced as early as 1998. Automobiles, however, will be excluded from the liberalisation policy (the gradual reduction of customs duties on cars will extend to 2002, the same concerns quotas for the Polish and EU markets).

In putting together a trade agreement (within the framework of the Europe Agreement) the parties followed two principles: the principle of asymmetry (in an effort to benefit the associated countries) and the standstill rule (with regard to trade protection instruments). The implementation of these principles did not however prevent the formation and continued growth of a trade deficit resulting from the competitive disadvantage and lower levels of protection existing in the economies of the candidate countries.[4] Currently all countries associated with the EU observe a deepening deficit in their trade with the Union. This is caused by the pronounced discrepancy between the dynamics of growth in imports and in exports.[5] Poland has become the fourth main export market in the domain of extra-EU exports (after USA, Switzerland and Japan), giving the EU the fourth trade surplus of ECU 7.6 bn (1996 Eurostat data, the surplus has been increasing through all of 1997, reflecting the insufficient competi-tiveness of Poland). Poland holds the fourth place after Hong Kong, Switzerland and Turkey with all the EU benefits of job creation and export-led growth. High growth in the levels of EU export trade (i.e. exports destined for Central and Eastern European markets)

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[3] The fact that Estonia made the list of the most likely candidates shows the initial bar on Baltic republics (caused by Russia's protests) has now been lifted. Candidate no. 1 is Cyprus which if included while Turkey remains outside may results in escalated tension.

[4] A.Inotai, A.Henriot, *Economic Interpenetriation between the European Union and the CEEC*, Institute for World Economics, Hungarian Academy of Sciences, Working Paper, no. 68 1996.

[5] The rapid growth in imports from the EU is a direct consequences of the fast increasing GPD and the high propensity to import. The problems has resulted from the limited capacity to "generate" exports which can to some extent be attributed to dilemmas faced in setting macroeconomic policies and specifically such factors as stability and real appreciation of exchange rates which serve as an anchor in the stabilisation program but have an adverse effect on the price competitiveness of export. The storage of export credit and insurance of exporting risk are among other factors undermining the growth of exports.

largely contributes to the microeconomic benefits enjoyed by the EU. These benefits include the benefits of scale economies and the expansion of sales markets, and do not usually figure in reports on the costs and benefits of Eastern enlargement.

The commodity structure of Polish exports (raw materials, semi-processed products, low value added goods) makes the Polish economy more vulnerable to the business cycle of EU importers (mainly Germany) due to a high-income elasticity of demand.

The free trade agreement negotiations, which took place with the participation of Poland and the EU in 1991, were an example of enlightened self-interest on the part of the Union. In spite of widely proclaimed praises of liberalism, EU negotiators secured considerable protection for EU markets and limited the accessibility of their market to the so called sensitive goods (such as steel, textiles, agricultural products). Access to these areas of the market was critical for Polish exporters – their share of total exports to the EU was approximately 50%.[6]

Table 1. GDP indicators of the candidate countries

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Bulgaria	-11,7	-7,3	-2,4	1,4	2,6	-10,9	-7,4	1,2	3,5
Czech R.	-14,2	-6,4	-0,9	2,6	4,8	4,1	1,2	2,6	3,6
Estonia	-11,0	-14,2	-6,7	-1,8	4,3	4,0	5,2	4,7	4,7
Hungary	-11,9	-3,0	-0,9	2,9	1,5	1,0	3,1	3,8	4,2
Latvia	8,3	-35,0	-15,0	1,9	-0,8	2,8	3,5	4,1	4,2
Lithuania	-13,1	-37,7	-24,2	1,0	3,0	3,6	5,0	5,4	5,7
Poland	7,6	2,6	3,8	5,2	6,9	6,1	6,0	4,7	5,2
Romania	-	-					-		

[6] According to Polish farmers, we are witnessing unfair competition in the trade in agricultural goods – Union goods are supported with internal financing and export subsidies.

	12,9	10,0	1,3	3,9	7,1	4,1	3,0	2,2	4,4
Slovakia	-14,5	-7,0	-4,1	4,9	6,8	6,9	5,3	4,5	3,6
Slovenia	-8,1	-5,4	1,3	4,9	3,9	3,1	3,4	4,3	4,6

Source: European Commission, DG II 1998 (1999 – forecast of DG II).

Even now contingent protection in the EU (e.g. anti-dumping procedures) is much stronger than in the countries applying for membership.[7]

Customs statistics, or the classification of products, may be manipulated to serve as non-tariff barriers. Depending on their classification, car components, to give an example, may wind up either exempt or subject to customs duties, which in the end will affect the cost of the final product.[8]

Another example is the way in which the regulations concerning the origin of goods are manipulated either to create an integrated trade space or to fragment markets. It appears that multinational companies are in a better position to benefit from the opening of markets and the cumulation of "local contents" than are the local companies of the candidate countries. An extension of the single market would foster the growth of FDIs, which require free EU market access. The EU certainly expects to attain a "margin of preference" for EU investors. This margin is diminishing as a result of the "multilateralisation" of global trade agreements concluded under the aegis of the WTO.

For Poland and the other candidate countries the Europe Agreement was a breakthrough in terms of an improvement of their 1980s situation. Little by little however, as the Agreements were implemented and the economic reform proceeded in Central and Eastern Europe, it turned out that the Europe Agreement is a lopsided deal with built-in mechanisms preventing equality and that there is much to be read between the lines. Take the issue of Poland's membership in the Union, which the Preamble to the Agreement treats in the following way: *"Recognising the fact that the final objective of Poland is to become a member of the Community and that this association, in view of the Parties, will permit to achieve this objective".*

This a declaration of the Union's intent shows much reserve and caution. It was only later, in June 1993, that the Copenhagen Summit introduced the

[7] Anti-dumping procedures are applied not only to protect markets and threatened jobs. They are sometimes conducted intentionally to lower the market value of a privatised enterprise to obtain a better price for a EU business. To quote *"Intereconomics"*: *"The flow of East-West trade in fields in which the transition countries are particularly competitive is either subject to quotas or even has the safeguard clause slapped upon it".* (P.Bauer, *Benefits and Costs of EU Entry for the CEEC, "Intereconomics"*, January/February 1998.)

[8] A case in point is the competitive war waged between EU and Daewoo in the Polish market.

following statement: *"the European Council today agreed that the associated countries in Central and Eastern Europe shall become members of the European Union. Accession will take place as soon as an associated country is able to assume the obligations of membership by satisfying the economic and political conditions required"*.

The Copenhagen Summit was a turning point in forging the relationship between the European Union and countries of CEE. The Summit specified the basic conditions to be met by countries applying for membership in the Union. Among these we find: the establishment of *"institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, the existence of a functioning market economy (...) the capacity to cope with competitive pressures and market forces within the Union"*.

The European Council issued the following general statement: *"The Union's capacity to absorb new members, while maintaining the momentum of European integration, is also an important consideration in the general interest of both the Union and the candidate countries"*. The concept was to be introduced during the 1996-97 Inter-Governmental Conference (IGC) and finalised with the Amsterdam Summit in June 1997.

In April 1994, Poland submitted its application for Union membership, as did other candidate countries between 1994 and 1996. Subsequent political directives from the Union coincided with EU summits. The Essen Summit, held in December 1994, formulated the pre-accession strategy to be followed by the candidate countries. This strategy centred around the approximation of the candidate countries' laws to those of the Internal Market. To facilitate the process, the European Commission (at the Cannes Summit in June 1995) approved a *White Paper* containing the key guidelines for adjustment to the Internal Market.[9] The *White Paper* was translated into the national languages of the candidate countries and constitutes a valuable aid to governments and parliaments in their work on the approximation of legal systems.

At the Madrid Summit in 1995, the opening of negotiations with candidate countries was scheduled for mid-1998, six months after the expected conclusion of the IGC. Meanwhile, the European Commission was to prepare a questionnaire for the candidate countries, the responses to which would become the basis for the so-called *Avis* or opinion on each of them.

During the Italian presidency – the first half of 1996 – the IGC (also referred to as Maastricht II) began its work. Its objective was to introduce modifications and amendments into the Union Treaty, with an eye to streamlining the decision-making process and specifying the role of individual Union institutions. At the

[9] *White Paper. Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union,* Commission of the European Communities, Brussels, CO (95) 163 final, Brussels 03.05.1995.

same time, the Commission sent the questionnaire (the factual basis of opinions) to each of the candidate countries.[10]

The Amsterdam European Council completed the work of the IGC, which was very significant for Eastern enlargement, mainly because of the timing of the negotiations (which are to start 6 months after the signing date of the Treaty). The final Treaty of Amsterdam was signed in October 1997. It seems that a short deadline and anxiousness to reach a consensus affected the final form of the Treaty. To quote *"The Economist": "By putting off the toughest issues, Europe's summits managed to adopt a new treaty – but one that still leaves the Union ill-prepared for its eastward enlargement".*[11]

In the Presidency conclusions from Amsterdam, we read: *"with the successful conclusion of the IGC, the way is now open for launching the enlargement process in accordance with the conclusions of the Madrid European Council".* The conclusions indicate the need for *"reinforcing pre-accession strategy and further developing pre-accession assistance building on ongoing reforms of PHARE".*

The European Council stressed the need to create a comprehensive report for its December meeting in Luxembourg. At this meeting, the Council took the necessary decisions on the overall enlargement process, including practical arrangements for the initial phase of negotiations and the reinforcement of the Union's pre-accession strategy as well as other possible means to strengthen co-operation between the EU and all applicant countries (the Accession Partnership was adopted as one of these means).

Few significant institutional changes were introduced in the Amsterdam compromise. A number of important changes were heralded however. What is and what already seemed obvious then, is that after enlargement, a Union comprised of 20-25 Member States would not be very efficient. Article 1 states the following on the need for change: *"At the date of entry into force of the first enlargement of the Union (...) the Commission shall comprise one national of each of the Member States, provided that by that date the weighing of the votes in the Council has been modified (...) compensating those Member States which give up the possibility of nominating a second member of the Commission".*

Article 2 states: *"At least one year before the membership of the European Union exceeds twenty, a conference (...) shall be convened in order to carry out a comprehensive review of the provisions of the Treaties on the composition and functioning of the institutions".*[12]

[10] Poland submitted its response in June 1996. The Commissions' Opinion was presented on June 16, 1997.

[11] *Mountains Still to Climb*, *"The Economist"*, 21.06.1997, p.27.

[12] *Protocol on the institutions with the prospect of enlargement of the European Union, Amsterdam European Council, 16 and 17 June 1997, Presidency Conclusions*. The statement led

The above political initiatives of the Union, most of which were formulated during European Council summits, coincided with efforts on the part of candidate countries, including Poland, to prepare for negotiations and membership in the Union. It is important to note the significance of the responses to the Commission's questionnaire made for the purpose of issuing the *Avis*, as well as the role of the "National Strategy for Integration", a document prepared by the Polish government.

The Commission's questionnaire for Poland consisted of 170 pages and posed questions on 23 areas. Answers to these questions were expected to enable the Commission to evaluate the extent of the approximation of laws and present an overall picture of the level of the country's development.[13] The answers were to focus on macroeconomic indicators, customs and tax policies, employment and welfare, the state of industry and agriculture, foreign policy and security. Some of the questions concerned the prospects for co-operation between Poland and the Union in the area of the justice system and internal affairs.

Other questions focused on the similarities between the Polish and the EU legal systems. The Europe Agreement set deadlines for the approximation of legislation in selected areas such as competition law or laws regulating state assistance. In other areas, the pace of approximation was left at Poland's discretion. Progress in the approximation of Poland's legal system would provide a strong negotiating point.

Responses to the questionnaire were presented in a 26 volume, 2 664-page work, prepared in co-operation with all of the ministries and central institutions. Poland completed this formidable task within three months (April to July 1996).

The basic text of the questionnaire was identical for all of the CEE states. In addition however, the questionnaire included different annexes directed to individual countries. In the case of Poland, such additional questions concerned the fishing sector (regulation concerning which did not figure in the Europe Agreement), the anticipated legal provisions for the protection of personal information, a question on whether Poland planned to establish a law enforcement agency independent of the public authorities, and whether, and if so, when does Poland plan to join the 1981 Convention 108 of the Council of Europe on the protection of persons in connection with the automatic processing of personal data.[14]

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some observers to believe that the first Eastern enlargement will result in admitting five new Member States.

[13] See: A.Mayhew, *Rozpoczyna siê opiniowanie polskiego wniosku o cz³onkostwo w Unii Europejskie (Screening of Polish application for the EU's membership has begun)*, *"Wspólnoty Europejskie"*, no. 2 (54) 1996.

[14] T.Radzimiñska, *Pytania dla Polski (Questions for Poland)*, *"Nowe ¯ycie Gospodarcze"*, 20.05.1996.

Preparing answers to the questionnaire proved to be a good exercise for the central administration and its agencies. It put their organisational efficiency and their ability to co-operate and co-ordinate projects to the test. It was treated as the first rehearsal before the commencement of accession negotiations.

Another important step on the Polish side was the publication of the "National Strategy for Integration", a document prepared by the Polish Government and approved by the Polish parliament.[15] The procedure is intended to ensure the continuity of Poland's policy towards the European Union even in the case of a replacement of the ruling elite and a change of guard in the parliament.

In its introduction, the NSI contains historical references and general statements: *"Our common European historic experience in the recent as well as the more distant past shows that societies remaining out of the mainstream of economic co-operation get left behind. Membership in the European Union requires substantial adjustments on the part of the Polish economy and its law. (...) It is therefore necessary to intensify preparations so that Poland will be able not only to fulfil the formal conditions of membership but also to gain the greatest advantage in the period up to and after accession (...) Integration with the Union is based on the conviction that it is a process which will bring advantages to both sides".*

The NSI is comprised of 8 parts. Part I discusses the "General Political Objectives". Part II focuses on the "Adaptation of the Economy", highlighting the possible costs and benefits, business strategies and the main areas of adaptation. Part III discusses the "Adaptation of Legislation". Next come parts devoted to External Affairs, Justice and Home Affairs, Training and Human Resources, Information Activities, and the Executive Summary.

The NSI points out that European integration will generate costs, not only the costs of changing laws, retraining and information, but also costs related to social and economic change. The Polish government believes that *"a large part of the adjustment costs could be financed from pre-accession funds and through transfers – and within the initial membership period, from structural funds". According to the NSI "Poland expects that the Union too, will show readiness to bear certain financial consequences of Poland's membership".*

The NSI stresses that Poland should also *"try to influence the development of the CAP through the building of alliances with other Member States and through a public debate held prior to and during the negotiations".* Poland will need transitional periods but to quote the NSI: *"our attempts to use these instruments will be prudent".*

[15] *National Strategy for Integration*, *Committee for European Integration*, *"Yearbook of Polish European Studies"*, no. 1 1997, p.180-233.

One issue, which is likely to prove an especially sensitive one in the negotiations, is that of the free movement of labour. On this issue the NSI states that: *"the fastest possible implementation (...) is in Poland's interest. This means eliminating or keeping short transition periods in achieving full access to labour markets of the Union"*.[16]

Other challenges to be dealt with include a rise in production costs due to the adopting of EU norms and standards, pressure on the job market due to workers being displaced from a reformed agricultural system, pressure for revaluation the Zloty due to an increased flow of capital, the reciprocal recognition of qualifications, the right to practice a profession, and an increased "brain-drain" from the outflow of skilled Polish workers.

Intensive preparations and training are being carried out within the framework of the Committee for European Integration and other central bodies. Five task forces and twenty nine work groups have been created, modelled after the groups set up to negotiate with the EFTA countries. The teams are headed by high-ranking government officials (vice ministers). Liaison officers have been appointed to co-ordinate the preparations.

Also created were impact assessment groups in charge of evaluating the effects of new legislation. The groups may modify the legislation proposed, as part of the legal approximation process.[17]

Preparations for the negotiations are now well under way and their organisation complete. Their progress has not been disturbed too much by the September 1997 elections. The commonly held belief is that the political and economic stability of a candidate country at the time of negotiations is crucial and may considerably speed up the implementation of the EU legislation.[18]

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[16] One should realise that the Union's position on this issue is exactly the opposite and all warnings of massive waves of migrant workers are greatly exaggerated. Nevertheless, this may turn out to be a powerful negotiation point.

[17] Needless to say, candidates are not authorised to change the essence of Union's guidelines. As R.Portes put it: *"There is no point in even thinking that you can influence EU policies, laws, regulations, etc. until and unless you are inside*". (R.Portes, *From Association to Accession*. The Windsor Group, Institute for East-West Studies, Warsaw-New York 1995, p.148.) A.Smith expressed a similar view: *"the two thousand pieces of community legislation annexed to the final EEA Agreement are a sobering remainder of the EU's requirements. The same reluctance of the EU to enter into reciprocal obligations with nonmembers is explicit in the White Paper (from Cannes)"*. (A.Smith et al., *The European Union and Central and Eastern Europe: Pre-Accession Strategies,* Sussex European Institute, Working Paper, no. 15, 1996.)

[18] As some authors put it: *"There are two types of difficulties with the Eastern enlargement (...) there are problems connected with achieving a proper distribution of the benefits from integration and avoiding negative externalities. On the other hand, there is the uncertainty problem regarding the newcomers' implementation of Union law and their future policy preferences"*. (J von Hagen, *The Political Economy of Eastern Enlargement of the EU*, *"Coming to Terms with Accession"*, CEPR & IEWS, London 1996.).

One of the statements likely to be heard in the negotiations as an argument for Poland's admission to the EU will be that its economy is *"not wealthy, but healthy"*, which is reflected mainly by the high GDP growth rate and sound monetary and fiscal policies. The inflation rate however shows signs of stubbornness.

2. Is it all about Structural Funds?

"Some of the sweetest courtships are followed by really unpleasant haggling over wedding arrangements".[19] "The sweetest courtship" may not be the best way to describe relations between the candidate countries and the Union, yet there is no doubt that talks on the prenuptial agreement will be fraught with difficulties. At the time of the Europe Agreement negotiations, structural funds were a taboo topic.[20] Even now the Union remains uneasy about the issue. The uneasiness has further been compounded by numerous quasi-scientific and politically motivated reports overestimating the cost of Eastern enlargement and presenting it as an Eastward transfer of the Union's budgetary resources.[21] The greater part of such analyses is not based on the cost-benefit method. They often overlook the fact the all of the Unions' budget accounts form a mere 1.27% of its GDP. Some of the studies simply extrapolate from the assumption that common policy (including agricultural policy) and financing structures will remain unchanged.

Part of the problem lies in the fact that considerable political forces and various lobbies have a strong vested interest in maintaining the status quo and in keeping to themselves the benefits drawn from CAP and structural funds. This was obvious during the last IGC, which changed nothing in this respect. According to some authors: *"Machiavelli would say these funds are payoffs to politically powerful special interest groups that might otherwise oppose European integration"*.[22]

As a matter of fact, in the violation of treaties, the candidates are offered the status of second-class members. After an update of the estimates of future transfers to the East, this original idea[23] was further elaborated and formulated as follows: *"The modalities of accession should include a 10-year transition*

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[19] R.Baldwin, *Towards an Integrated Europe*, CEPR, 1994.

[20] The author served on the government team which negotiated the Europe Agreement.

[21] E.g. the report of T.Böhne of the European Parliament who expressly states that Poland is not suited for membership because its GDP is low and its agriculture employs 25% of the professionally active population. There is no dynamic or long-term perspective. (T.Böhne, *The Eastern Enlargement of the European Union – Can the Financial Implications be Estimated*?, European Parliament, February 1997.).

[22] R.Baldwin, op.cit.

[23] Ibidem.

period, during which agricultural trade and mobility of labour will be gradually liberalised. The applicant countries should renounce their claims to EU structural funds, both because they do not need them and because the fear amongst some EU countries (Spain, Portugal, Greece, Ireland) about the diversion of structural funds now represents a large hurdle to quick accession. In fact reliance on structural funds would probably worsen the political culture of the new members".[24] Could the candidate countries be treated with more care?[25] Instances of such hypocrisy discourage many individuals in CEE countries, who strongly believe in European ideals.

We can find examples of a very pragmatic type of approach being applied in previous enlargements. A group of incumbents (Greece, France and Italy) demanded a special budget allocation in return for accepting the Iberians, the rationale being that the Iberians' southern agriculture was a threat to the Mediterranean incumbents. The result was the proposal of the Integrated Mediterranean Programme – a project designed for 3-7 years that cost about ECU 6.6 bn.[26]

A second much larger change was the doubling of structural spending that accompanied the ratification of the Single European Act in mid-1987.

After the Iberian enlargement, the budget threatened to become a vehicle for massive international income redistribution. At the Edinburgh Summit in December 1992, EU leaders created the Cohesion Fund and crafted the eligibility criteria to ensure that only the poor 4 qualified. Some authors[27] claim that the poor four used their veto power over the Maastricht Treaty as a lever to tap into the Cohesion Fund – that's it for *"power politics"*. It was only after the Iberian enlargement that the poor four countries got 21 of the 76 Council votes – a major shift in the distribution of power, which led to major changes in budget priorities.

An interesting attempt to estimate the costs and benefits of Eastern enlargement for the EU and the five CEECs (4 Visegrad countries plus Slovenia) can be found in a work by R.E.Baldwin, J.Francois and R.Portes.[28] It is all the more interesting due to the fact that R.E. Baldwin, the author of the hub and spoke integration model, was also the author of one of the first works on the cost of Eastward enlargement. The work gave some very high estimates for Eastern

[24] A.de Crombrugghe, Z.Minton-Beddeos, J.D.Sachs, *EU Membership for Central Europe, Commitments, Speed and Conditionality*, *"Cahiers de la faculté des sciences economiques et sociales"*, no. 29, 1996.

[25] A similar opinion, although with a different explanation, can be found in A.Smith et al., op.cit.

[26] D.Allen, *Cohesion and Structural Adjustment* in: *Policy Making in the European Union*, ed. H.Wallace, W.Wallace, Oxford University Press, Oxford 1996.

[27] D.Allen, op.cit.

[28] R.E.Baldwin, J.Francois and R.Portes, *The Costs and Benefits of Eastern Enlargement: The Impact on the EU and Central Europe*, "*Economic Policy*" no. 24, April 1997.

transfers. This goes to prove that there has been a considerable evolution of views and approaches.

The aforementioned work indicates that the estimates of the costs of Eastern enlargement[29] were based on a simple extrapolation from the current level of per capita structural fund receipts. T.Courchene took the average for Greece and Portugal (ECU 200) and multiplied it by two in reference to the provisions of the Edinburgh Summit, thus obtaining ECU 400. Multiplying this figure by the 64 million inhabitants of the 4 Visegrad countries, he arrived at the figure of **ECU 26 billion.**

The result was questioned by the European Commission, as in the year 2000 the amount would account for 10-15% of the candidate countries' GDP and would therefore require a high degree of aid absorption and the ability of CEE governments to provide matching funds, which would be highly unlikely. The authors thus suggested taking 5% of the GDP as a more realistic upper limit. Projected Visegrad SF spending under this rule amounts to **ECU 12.8 billion**.

Estimates of the CAP cost of Visegrad enlargement range from ECU 4 bn to ECU 37 bn.[30] All 1996 estimates put the cost at ECU 5-15 bn with **ECU 10 billion.** being the most probable estimate. Such CAP transfers to Visegrad countries would spell a subsidy of ECU 2,221 per farmer and ECU 318 per hectare. For comparison, according to 1994 data, subsidies per farmer in the EU fluctuated between ECU 12,290 in Belgium to ECU 1,514 in Portugal, while subsidies per hectare ranged from ECU 967 in the Netherlands to ECU 200 in Spain.

Under this scenario, the enlargement encompassing the Visegrad 4 would result in spending ECU 10 bn for the CAP and ECU 13 bn for cohesion. Assuming the countries' growth to be at 6% *per annum* on average from 1994 to 2000, their combined GDP should be about ECU 440 bn, and according to R.Baldwin et al., accession in the year 2000 would implicate contributions of about ECU 4 bn. The net cost should amount to about ECU 19 billion, 19% of what the 1999 budget would be without enlargement.

According to many authors, joining the EU will make the CEE countries less risky for investors. EU membership codifies well-defined property rights as well as competition and state aid policy. It secures convertibility, open capital markets and rights of establishment. It guarantees unparalleled access to the EU: the 15 markets constituting 30% of the world's income. Membership puts CEE on a path towards eventual monetary union and thus provides a solid barrier against inflation spurts.

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[29] T.Courchene, C.Goodhart, A.Majocchi, W.Moesen, T.Prud'homme, F.Schneider, S.Smith, B.Spahn and C.Walsh, *Stable Money – Sound Finances*, "*European Economy*", no.53, European Commission, DGII, Brussels 1993.

[30] K.Anderson, R.Tyers, *Implications of the EC Expansion for European Agriculture Policies, Trade and Welfare* in: *Expanding Membership of the European Union*, ed. R.Baldwin, P.Haaparanta, J.Kiander, Cambridge University Press, Cambridge 1995.

Some authors[31] put emphasis on the „EU accession effect" which has been an important factor in Spain and Portugal and could be at least as strong if not more so in Central and Eastern Europe, where future reductions in risk premia in the financial markets could signify the credibility of accession policies and consequently trigger major investment.

Let me once again quote a passage from R.Baldwin, which although it represents my very sentiments, has luckily been penned by Western authors: *"Eastern enlargement is not really about transfers and narrowly defined economic benefits. Eastern enlargement is an essential pillar in Europe's post Cold War architecture (...) imagine that we had done the same economic cost versus budget transfer calculations for Luxembourg and Denmark. Given the massive per capita subsidies they receive and the small size of their economies, we would almost certainly have found that EU would gain on narrow economic grounds from expelling Luxembourg and Denmark (...) the Union's primary purpose is to ensure peace and stability in Europe. Economic integration is the means, not the end".* [32]

3. New developments

According to the "Agenda 2000", Structural Funds should be reformed:[33]

1. There should only be three Objectives in order to concentrate funds on key problems: Objective 1 and Objective 2 define former priorities (urban or industrial decay, rural development, fishing etc.), Objective 3 – human resources (old objectives 3&4).

2. Total allocation for 2000-2006 will be ECU 275 billion at 1997 prices: of this ECU 210 billion for the existing Structural Funds, ECU 20 billion for Cohesion Funds and ECU 45 billion for the new Member States. Receipts from Structural Funds should be capped at 4% of a recipient country's GDP.

There are some issues left unanswered in the "Agenda 2000", especially for the associated countries[34]:

– Will there be a single system of structural funding after enlargement or will there be one system for the old Member States and one for the new Member States ?

[31] M.Emerson, *Redrawing the Map of Europe*, public lecture at the LSE, Centre for Economic Performance, November 19, 1996.

[32] R.Baldwin, et aliens, op.cit.

[33] *Agenda 2000. For a stronger and wider Union*, *"Bulletin of the EU"*, Supplement 5/97.

[34] A.Mayhew, *Eastern Enlargement: a win – win Enterprise*, *"The European Policy Centre Occasional Paper*", Brussels 1997.

- When the "Agenda 2000" talks about strictly limiting Objective 1 areas to those with less than 75% of average Union GDP, is it talking about the whole enlarged Union or only about the EU as comprised of 15 states?
- How will transition periods function?
- Will be the same rules apply to Structural Funds after the year 2000 (e.g. will the confinancing ratio remain the same?)

At the meeting in Luxembourg in December 1997 the European Council decided that the Accession Partnership would be the key feature of the enhanced pre-accession strategy, mobilising all forms of assistance to the applicant countries. The purpose of the Accession Partnership is to set out in a single framework the priority areas for further work, as identified in the Commission's Opinion on Poland's application for membership in the EU.[35]

Certain policy instruments are envisaged, including the National Programme for the Adoption of the *acquis,* the Joint Assessment of Economic Policy Priorities, the Pact against Organised Crime and the Internal Market "road maps". The priorities have been divided into two groups. The first set should be completed or forwarded in 1998 (to be included in the Commission's report to the Council at the end of 1998). The second set is expected to take several years to complete.

Poland has been invited to draw up a National Programme for the Adoption of the *acquis* by the end of March, 1998 which should set out a timetable for achieving priorities as well as intermediate objectives, and indicate the staff and financial resources required.

Beginning in 1998 PHARE assistance has been channelled through the following types of actions:

1. Institution building (around 30%) – initially – according to the European Commission this support will focus on priority areas such as finance, agriculture, environment and justice and home affairs.
2. Investment support (around 70%) which will concentrate on:

- structural actions: agricultural restructuring, regional development and investment in human and intellectual capital,
- compliance with Community norms concerning: the environment, agriculture, industry, occupational safety and health, transport and telecommunications,
- co-financing of large-scale infrastructure,
- small and medium enterprise development.

In anticipation and in preparation for the reception of Pre-Structural Funds and the Pre-Feoga, the Government of Poland plans to establish in 1998 (preferably in the Ministry of Finance) a National Fund for Investment Promotion and Institution Building, functioning under the responsibility of a National Authorising Officer.

[35] "Poland: Accession Partnership", Draft 9/2/98.

It is also stressed that the regulatory and monitoring bodies must be strengthened in fields such as competition, securities, insurance, banks, money laundering, public procurement, consumer protection, transport safety, standards and certification, and finally labour inspectorates. [36]

The Accession Partnership appears to be a prescriptive, one-sided solution, drawn up exclusively to the measure of the EU, without reference to the perceived needs of the associated country. As A. Mayhew points out: *"It is difficult to imagine how free and productive negotiations can take place if the EU side is using the Accession Partnership and annual reports to force the associated countries to do what it cannot achieve in negotiations"*.[37]

4. On some advantages of Eastern enlargement

Eastern Enlargement should be viewed within the broader context of ongoing global processes and global challenges. In the short run ten EEC candidates[38] will enlarge the EU territory by 1.078 million square kilometres (around 33%). The population of the Union will increase by 106 million people (about 30%), while the GDP will rise by 637 billion (9% in terms of purchasing power parties). Although the last figure is not very impressive, it should be noted that the enlargement would bring about stability and accelerate growth. This would constitute a factor indispensable to Europe's competitiveness in the future. As A.Inotai puts it: *"it would increase pressure on Western Europe to reform its structures in order to replace the outdated and increasingly costly status quo mentality with new, innovative behaviour"*.[39]

The EU will be enlarged step by step, so that costs can be spread over a longer period of time. The costs could be reduced by better adjustment on both sides. Growing competitive pressure is caused mainly by global competition and not so much by preparations for enlargement, which goes to show that enlargement is a necessary step.

The trade related instruments of the Single European Market are gaining importance, opportunities for the generation of profits are thus increasing for

[36] For the accession negotiations a new task force has been set up in the Commission, called GISELA (Group Interservice Elargissement). It is a network of experts from all the Commission Directorates – General and the Secretariat General, the Legal service, the Statistical Office, the Cellule Prospective and Euroatom. See: *A Guide to the Enlargement of the European Union: Determinants, Process, Timing, Negotiations*, European Institute of Public Administration, Maastricht 1997.

[37] A.Mayhew, *Eastern Enlargement...* op.cit., p.66.

[38] Ten CEEC which have signed association agreements with the EU: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.

[39] A.Inotai, *Costs, Benefits and Chances of Eastern Enlargement for the European Union*, Bertelsmann Foundation Publisher, Gutersloh 1998, p.13-37.

European companies. These opportunities are widely manifest in the domain of services, since in most of the CEE countries the services sector is not yet developed. Growth of demand for services is a function of GDP dynamics, intra-industry penetration and FDI inflows.

Additional profits in trade in the period of accession would stem from:

- the liberalisation of agricultural trade
- increase in the activity of strategic multinational corporations
- an increased propensity on the part of the CEE countries to import, as a result of EU funding of important projects.

For many multinationals Eastern enlargement could be the means of consolidating already-achieved gains, and could serve as a basis for the development of new market positions.

Eastern enlargement will help Europe enhance its global competitiveness versus the USA, Japan and the Pacific Rim area. Cost advantages through trans-national specialisation – as CEE countries offer well educated and cheap staff – are to be realised. The first attempts at using these advantages have been the result of the strategic planning of multinational corporations[40]. Business seems much more far-sighted than the EU politicians concentrated on the issues of deepening the integration processes.

Eastern enlargement can be seen in the context of globalisation, the acceleration of technological development and the establishment of the information society. CEE countries are in a position to strengthen European competitiveness thanks to their innovative capacity as well as their high degree of social and institutional flexibility. Unfortunately at the moment the EU sees the Eastern part of Europe as a danger to the "social achievements" of the welfare state.[41]

It should be stressed that in terms of international capital, CEE is not competing against the EU but against locations all over the world.[42]

As for the case of Poland, the latest issue of the World Bank's report reads: *"EU membership will put pressure on Poland to upgrade or adapt skills. The starting point is a relatively highly educated population. With an adequate education system, investment in skills is expected to yield high returns"*.[43]

In the meantime the CEE states suffer as a result of the increasing EU balance of trade surplus. The German Institute for Economic Research produced analyses showing that trade with CEE increased employment in Germany by

[40] There are already examples of transfer of skill intensive production into some CEEC as well as of establishing regional or European R&D centres.

[41] See A.Inotai, op.cit., p.24.

[42] CEE countries have the "late comers" characteristic – i.e. modern technology transfer not hampered by institutional, juridical, social barriers; on the brink of information society it can be a precious asset.

[43] *Poland. Country Economic Memorandum*, World Bank 1997.

60.000 workplaces in 1993. At the same time unemployment in CEE grew significantly.[44]

Export-led growth should be viewed as one of the greatest advantages of the EU in the process of enlargement. Both the East and the West of Europe should be subject to mutual adjustment. An over-regulated EU loses its competitive edge vis à vis the third countries, while the CEE countries gain dynamism thanks to their flexibility. Both sides should probably meet somewhere in the middle of the road for the sake of Europe.

[44] According to Polish estimates the officially registered balance of trade deficit with the EU means the loss of 1.2 to 1.4 million jobs. See M.Kabaj; *Transformation, internal determinants and threats for the competitiveness of Polish economy (1996-2000),* Warsaw 1997.