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The Consequences of Eastern Enlargement of the European Union in Stages

Susan SENIOR NELLO and Karen E. SMITH

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Contents

I. Introduction[1]

Ten Central and East European countries (CEECs) applied for EU membership between 1994 and 1996: Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia. All ten have signed association ("Europe") agreements with the EU, although the agreements with Estonia, Latvia, Lithuania and Slovenia have yet to be ratified. All are participants in the EU's "pre-accession strategy", which is to help prepare them for eventual membership.[2] Enlargement is widely considered to be the way to spread stability and security eastward, and has been agreed to by the Union for that end.

Clearly, not all ten countries will accede to the EU at the same time, even though officially the EU does not make distinctions between the associates.[3] The Commission will present its opinions on all the applications in July 1997, following the conclusion of the intergovernmental conference at the June 1997 Amsterdam European Council. The December European Council could then decide to open negotiations with suitable applicant countries.

Enlargement should depend on whether the applicant meets certain conditions, which were laid down in June 1993 by the Copenhagen European Council:

- the applicant state must have a functioning market economy with the capacity to cope with competitive pressures and market forces within the Community;

- the applicant state must have achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;

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[1] Susan Senior Nello is responsible for the economic content of the paper, and Karen Smith for the political and institutional aspects. The paper was presented as a background paper for the first meeting of the European University Institute Working Group on Eastern Enlargement, in May 1997. It was subsequently revised in June 1997 (thus prior to the publication of the Commission's opinions on the CEEC membership applications). The authors would like to thank the members of the Working Group for their useful comments on the background paper. We would also especially like to thank Jan Zielonka and Yves Mény for involving us in the Working Group and encouraging us to prepare this paper.

[2] The pre-accession strategy was approved by the December 1994 Essen European Council, and includes PHARE aid targeted to helping the associates prepare for accession, and the structured relationship, in which the associates and the various sectoral, and General Affairs, Councils meet regularly.

[3] Péter Balázs charges that the EU's treatment of the Central and East European associates is increasingly uniform, without differentiating between faster and slower reformers. Balázs (1997), pp. 11-12.

- the applicant state must be able to take on the obligations of membership, including adherence to the aims of economic and political union; and

- the EU must be able to absorb new members and maintain the momentum of integration.[4]

Because not all applicants will meet the conditions, enlargement will take place in "waves", to some countries before others. It is likely that each wave will include more than one applicant state, as this is the most practical way of handling the large numbers of applicants. At present, three Visegrad countries seem to head the accession queue: the Czech Republic, Hungary and Poland. Other possible candidates for early enlargement include Slovenia, because of its positive economic performance, and Estonia, partly because of its progress in economic transition, but also because of the apparent need to show solidarity and political support to at least one of the Baltic states.

The process can be thought of as one of "concentric enlargement", but this seems to indicate that the countries most likely to join in the first wave are those geographically closer to the Union.[5] Instead, "enlargement in stages" will be used in this paper. The term is preferred to concentric enlargement because it does not imply that the process will occur to those countries geographically closer to the Union (though this might in fact happen).

The approach used here is intended to be positive rather than normative (though in practice distinction between the two is sometimes difficult). In other words this paper does not address the question of how, when and with whom should enlargement proceed. Instead, part II of this paper attempts to identify criteria which could be used to decide whether countries are ready to join. Part III of the paper is concerned with the probable consequences of enlargement proceeding in stages. In particular, the aim is to assess whether (temporary) exclusion from the EU is likely to worsen the economic and political situation of the countries left out. The final two parts will discuss possible solutions to the problems posed by enlargement in stages.

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[4] European Council in Copenhagen, 21-22 June 1993, Conclusions of the Presidency, SN 180/93, p. 13.

[5] The term derives from "concentric circles", the design for the post-Cold War European architecture advocated in 1989-1990 by then Commission President Jacques Delors and German Foreign Minister Hans-Dietrich Genscher. The Community, at the center, would be strongly integrated, and surrounded by countries that were more closely linked to the Community the closer they were geographically to it. Tight links would be established with the EFTA countries, via the European Economic Area, whereas the East European countries would become associates. The Community would maintain looser ties with the Soviet Union and other outsiders such as the US.

II. The EU's Membership Conditions: Assessing Fulfillment

A. The economic criteria for enlargement

Among the membership conditions are that the applicant country should have a functioning market economy with capacity to cope with competitive pressures and market forces within the Community, and should endorse the EU's objectives including those of economic and monetary union. The next section will discuss the indicators which could be used to assess the extent to which the CEECs have developed "functioning market economies". The section which follows will deal with the capacity of the CEECs to cope with competitive pressures and market forces within the Community. Then there will be a brief description of what is implied by acceptance of the acquis communautaire in the area of the Single Market, since, as Smith et al. (1996) suggest, it also seems likely that the speed and progress of the accession negotiations will depend on success in the programme for regulatory alignment set out in the Commission's 1995 White Paper.

It is useful to consider what indicators could be used to assess the extent to which the CEECs have developed a functioning market-oriented economy. The aim here is to draw up tables of indicators which summarise the economic "readiness" of CEECs for accession. These relate to the macroeconomic performance of the CEECs, and to their success in microeconomic transition (restructuring, privatisation and systemic change).

No attempt is made to assign weights reflecting the relative importance of the different indicators. As the range of indicators is so wide, some of these may be in contradiction with each other, so the EU has a certain amount of discretion in deciding which applicant countries should join when.

Progress in creating a functioning market economy

i) Indicators of macroeconomic performance

It is useful to take the Maastricht criteria as a starting point in the search for suitable indicators to measure macroeconomic performance, though it is important to recall that convergence criteria are not the same as accession criteria. Accession criteria should assess whether the applicant country has taken all the necessary political and economic reforms to prepare for membership. The Maastricht convergence criteria were introduced in an attempt to ensure that the constraints on policy implied by the EMU are acceptable to the country concerned. Their aim is to avoid destabilising the EMU by the premature admission of countries whose underlying economic performance is not yet compatible with permanently fixed exchange rates.

The Maastricht Treaty spelt out five criteria:

i) Successful candidates must have inflation rates no more than 1.5% above the average of the three countries with the lowest inflation rate in the Community.
ii) Long-term interest rates should be no more that 2% above the average of that of the three lowest inflation countries. This is to ensure that inflation convergence is lasting, because otherwise higher expected future inflation in a country would be reflected in higher long-term interest rates.
iii) The exchange rate of the country should remain within the "normal" band of the ERM without tension and without initiating depreciation for two years. At the time of the Maastricht Treaty the "normal" band referred to the margins of +/-2.25%, but since August 1993, in some circles it is now taken to refer to +/-15%.
iv) The public debt of the country must be less than 60% of GDP.
v) The national budget deficit must be less than 3% of GDP.

The last two on the list (iv and v) are referred to as the "fiscal" criteria and are subject to an escape clause. A country may be granted a waver if the gap between the actual and reference situation is "exceptional and temporary" or if the excess in public deficit or debt is declining "continuously and substantially".

There are several drawbacks in using the Maastricht criteria as indicators of the economic performance and success in transition of the CEECs:

i) The Maastricht criteria are indicators of macroeconomic performance, and the experience of transitional economies suggests that in assessing their readiness to join the EU, account should also be taken of microeconomic developments (economic restructuring and privatisation), and progress in systemic change. Transition is an ongoing dynamic process and even if a CEEC meets the criteria at a particular moment, this is not necessarily a guarantee that it will continue to meet the criteria on a sustainable basis.[6]
ii) Even as indicators of macroeconomic performance the Maastricht criteria can be criticised. The experience of the present EU member states suggests that success in meeting the convergence criteria may be at the expense of foregone

[6] As the Christodoulou Report (1996) of the European Parliament (Annex I, p. 17) points out, this is particularly likely to be the case if CEECs have not completed structural reforms, introduced sound economic and fiscal policies and achieved a satisfactory level of convergence.

growth (or recession) and higher unemployment. Given the already high levels of unemployment in the CEECs, and the urgent need for economic restructuring, these further indicators ought to be taken into account.[7]

iii) Some of the concepts underlying the criteria (such as fiscal deficit or long-term interest rates) assume a different meaning in transitional and market-oriented economies.

iv) The priorities of macroeconomic stabilisation programmes as well as the difficulties which they encounter in the transitional economies may differ from those of existing EU members.

The concept of public deficit in the Maastricht Treaty refers to central, regional and local government as well as social security funds. As Daviddi and Ilzkovitz (1996) point out, the budget situation of local and regional governments is often difficult to assess in the CEECs. The creation of adequate social safety nets is a central element of the transformation process and this could lead to a substantial increase in government deficits.[8] A clearer understanding of how privatisation has been taken into account in calculating public deficits is also necessary.

With regard to interest rates, the underdeveloped long-term capital markets in many of the CEECs means that data on long-term bonds is generally not available for these countries. Table 1 (in appendix) therefore sets out both long-term bond yield for some of the present EU members, and the Central Bank discount rate and lending rates for these countries[9] and some of the CEECs to illustrate that interest rates are generally higher in the latter.

The Maastricht criteria refer to public debt, but the legacy from the past means that in general data for the CEECs refers to <u>foreign</u> debt. The burden of foreign debt in Poland and Bulgaria (see Table 2, in appendix) was such that both these countries were forced to seek rescheduling.[10] It was largely fear of loss of confidence (which

[7] In Poland the new constitution introduced rules fixing the maximum levels of public deficit and debt at the Maastricht levels, but the incomplete nature of the transformation process, the high level of unemployment and the need for social safety measures suggest that these constitutional rules might impose a heavy social cost.

[8] A further difficulty could arise from the high share of budgetary redistribution in GDP. According to Palankai (1996) this amounted to 60% for Hungary in 1993, compared with 40-45% in Western Europe, and 46% for the Czech Republic.

[9] The discount rate is defined as the rate at which monetary institutes lend or discount eligible paper for deposit money banks. The lending rate is used to meet the short-run and medium-run financing needs of the private sector.

[10] In April 1991 the Paris Club agreed to debt relief on some 50% of Polish debt which was backed by Western governments, reducing the total from $33.7 billion to $18 billion over five

might have jeopardised the relatively high level of foreign direct investment) that prevented Hungary opting for a similar measure. Debt service payments accounted for more than 25% of budgetary expenditure in Hungary and Bulgaria, and 17% in Poland in 1995.[11] The debt service burden of these countries is worsened by high interest rates which are used to combat inflation.

As shown in Table 2, inflation is proving extremely resilient in the CEECs, and in particular, in the Baltic region, Romania and Bulgaria. With the exception of the Czech Republic and Croatia (though the latter statistic does not appear very convincing), inflation remains in double figures. Economic transformation may contribute to inflationary pressures through the reduction of product subsidies, the ending of the CMEA trading system (and the consequent increase in energy prices), devaluation and increased public spending on infrastructure and unemployment benefits, wage indexation, and, in some countries, servicing of the public debt. As a result there may be increased inflationary expectations and these could prove self-fulfilling. In many cases the centrally planned economies were characterised by excess purchasing power in the hands of the population (monetary overhang) because of the shortages of goods. The effect of price liberalisation was to render this repressed inflation open (Nuti, 1986). The high levels of interest rates in most CEECs reflect the need to reduce these inflationary pressures.

Tables 2-4 present some of the main indicators reflecting the macroeconomic performance of the CEECs, and Table 5 represents an attempt to draw these together.

Though the Maastricht criteria may be inappropriate as accession criteria, they cannot be ignored in view of the obligation of CEECs joining the EU to endorse the ultimate objective of economic and monetary union (EMU).

As Daviddi and Ilzkovitz (1996) describe, it is unlikely that the objectives and rules of EMU will be modified for the new CEEC members. Given the time lag before enlargement, if EMU proceeds according to the timetable set out in the Maastricht Treaty, it seems likely that it will be in Stage 3 when the CEECs at the head of the accession list join. As non-participating countries (i.e. with derogations from EMU) during Stage 3 those countries would none the less be obliged to follow rules relating to fiscal discipline, liberalisation of capital movements and the coordination of economic policy. Their central banks would participate in the European System of Central Banks (ESCB), and they would be obliged to ensure the independence of their central banks, and accept the primary objective of price stability. Non-

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years.

[11] UN/ECE, *Economic Bulletin for Europe*, vol. 47 (1995).

participating countries would, however, be allowed to conduct their own monetary policy and would not be subject to the guidelines of the European Central Bank (ECB). Member States with derogations would have to participate in some form of exchange rate arrangement with participating countries, but they would not have to completely fix their exchange rate to the euro.

In taking on the *acquis communautaire* with regard to EMU, even as non-participating countries the CEECs would therefore have to accept obligations with regard to price stability, exchange rate stability and fiscal discipline. Given the inflationary pressures associated with transition, the need to cope with capital movements, and the burden imposed by transformation on the budget, these obligations could prove difficult to meet. The loss of the exchange rate instrument and of control of monetary policy implied by full participation in EMU could be even more costly for the CEECs.[12]

ii) Progress in microeconomic restructuring and privatisation

Though the questions of macroeconomic performance and progress in transition are intrinsically interlinked, it is useful to shift the emphasis to the questions of microeconomic restructuring and privatisation. Microeconomic restructuring entails the correction of the distortions arising from the central control of pricing and the allocation of resources. This is achieved by privatisation, demonopolisation, the end of mandatory planning and the liberalisation of prices, trade and of capital and labour markets.[13] The priorities of the previous system have to be reversed with less emphasis on heavy industry, and a greater role for services and forms of production which are less intensive in pollution and energy. Transformation also implies reform of the fiscal system, which includes introducing taxes on income and value added in place of turnover taxes, and widening the tax base. In order to implement such measures an adequate legal framework with regard to property rights, contracts, competition and company law is also necessary.

Institutional changes in the financial sphere include the creation of independent central banks, a commercial banking system, financial markets for bonds and shares and adequate monetary instruments. It is also necessary to find a solution to the widespread diffusion of "bad debts" of state enterprises which managed to obtain credit from the state and from each other in order to continue operating and avoid (or at least postpone) bankruptcy.

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[12] An analysis of this question is not possible here, but for a more detailed discussion see Daviddi and Ilzkovitz (1996).

[13] For a more detailed discussion of these questions see Senior Nello 1991 and 1996.

In assessing progress in microeconomic transformation, a detailed analysis of the economy in question is necessary. Table 6 produced by the European Bank for Reconstruction and Development (EBRD) attempts to bring together and summarise the main indicators of progress in transition. Further indicators could be added to this list, such as the rates of growth and of investment, and the ability to reduce unemployment, which are shown in Table 4.

Capacity to cope with competitive pressures and market forces within the Community

With regard to capacity to cope with competitive pressures and market forces within the Community, the risk is that with removal of the barriers many firms in the CEECs whose output was destined for the domestic or former CMEA[14] markets would be unable to survive in an enlarged EU market. Against this it can be argued that the CEECs have an advantage as a result of lower wages, but in many cases this is offset by the structural shortcomings of industries.[15]

Although productivity has been increasing in most of the CEECs in recent years, there has been considerable pressure for wage increases, fulled by the need to raise low living standards. In some cases (and notably the Czech Republic in early 1997), nominal currency stability has undermined the cushion which undervalued exchange rates provided in the early years of transition. One of the results of legislative approximation with EU measures in the areas of social and environmental policies[16] could be to raise production costs in the CEECs.

The question of whether the CEECs will be able to cope with competitive pressures within the Community is rendered particularly acute as it has a sectoral dimension. Sensitive sectors, such as agriculture, textiles, clothing, coal, footwear, steel and chemicals[17] continue to occupy an important position in the CEEC economies. These are the sectors which tend to be characterised by overproduction at a world level, and the present EU members are committed to concerted efforts at reduction of

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[14] Council for Mutual Economic Assistance or Comecon.

[15] For instance, as the EC Commission's Agricultural Strategy Paper (1995), p. 7, argues, despite lower labour costs, inefficiencies in food processing and distribution mean that a doubling or more of wheat prices between the farm gate and the border is not exceptional in many of the CEECs.

[16] This issue will be taken up in the next section.

[17] The inclusion of chemicals among the sensitive sectors is justified by the large share of EU anti-dumping measures in this sector, but it is not accepted by all authors. For instance in CEPR (1992) chemicals are not included in the list of sensitive sectors.

capacity in some of these sectors such as steel and agriculture.[18] Relatively low wages may render the CEECs competitive in the sensitive sectors, but frequently this advantage is offset by structural weaknesses.[19]

Though the Copenhagen criteria refer to the ability of the CEECs to withstand competitive pressures in an enlarged EU, the question also arises for the existing EU(15) member states. The sensitive sectors play an important role in the weaker regions and member states such as Greece and Portugal. With the removal of barriers there is a risk that some of the weaker EU firms would no longer be able to compete with low-cost production in the CEECs, so the EU would experience higher rates of unemployment and closures.[20]

Various arrangements have emerged to meet this fear. For instance, outward processing trade has been used widely in the clothing and textiles industries and this largely accounts for the rapid increase in the CEEC share of extra-EU imports of these products.[21] The share of CEEC exports in extra-EU imports of motor vehicles also rose,[22] partly as a result of the role played by Western subcontracting and investments.

It is difficult not to conclude that, at least in the early years of transition, manufacturing in the CEECs was characterised by inertia, with little strategic adjustment away from the sensitive sectors.[23] Firms have tended to act in a defensive

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[18] For example the CAP has involved production quotas for sugar since 1968, and for milk since 1984. In addition, set-aside, or the policy of leaving land uncultivated was first introduced in 1988, and its use was greatly extended by the MacSharry reform of 1992.

[19] For instance, as the EC Commission's Agricultural Strategy Paper (1995, p. 7) argues, despite lower labour costs, inefficiencies in food processing and distribution mean that a doubling or more of wheat prices between the farm gate and the border is not exceptional in many of the CEECs.

[20] Cadot and de Melo (1995) have used estimates of a gravity model, and extrapolations of observed structural developments to analyse whether increased imports from the CEECs are likely to result in job destruction in the EU. Their simulations suggest an upper limit of some 13,000 jobs being lost in the EU, with very little regional concentration (apart from some 850 jobs being lost in coal production in Lorraine).

[21] CEEC(6) share of extra-EU imports of these products rose from 7% for each group in 1989, to 13% and 14% respectively in 1994 (UN/ECE, *Economic Survey of Europe 1995-1996*).

[22]The share of CEEC(6) exports in extra-EU imports of motor vehicles increased to 5.3% in 1994 (UN/ECE, *Economic Survey of Europe 1995-1996*).

[23] As Drábek and Smith (1995) illustrate for Poland, the Czech Republic, and Hungary, if agriculture is excluded from the analysis, the share of remaining sensitive products in total exports has been rising.

way cutting costs and reducing production levels, and investment to alter the pattern of production has been limited (Bofinger, 1995). The CEECs are faced with the urgent task of developing high technology sectors, such as telecommunications, and of setting up adequate banking and financial services. However, as Palankai describes (1996, p. 247), newly established domestic private firms are in a weak position as they have to cope with the "infant industry syndrome" which involves building new capacities, looking for new markets, consolidating management techniques and so on. Foreign direct investment, strategic alliances with Western firms and joint ventures can play a key role in this process.

The importance of such measures finds confirmation in the more recent theories of international trade, advocated *inter alia* by Krugman and Venables (1990). These authors criticise traditional theories of international trade for defining the comparative advantage of a region in terms of natural endowment, and argue that deliberate strategies such as investment in infrastructure, people, and R&D may be more important. National and EU policies may therefore play a key role in determining the shape of an enlarged market.

As will be discussed below, it seems likely that the creation of a larger, less fragmented market will create greater opportunities for investment and growth. A vast literature[24] emerged in connection with the 1992 Single Market Programme illustrating how integration can stimulate competition and technical progress, and enable static and dynamic[25] economies of scale to be exploited. Insofar as enlargement succeeds in creating a more dynamic economic environment, some of the adjustment costs might be eased.

The extent to which integration may contribute to creating a more competitive and dynamic environment will depend on how far the production of goods appearing in trade is characterised by imperfect competition. The usual indicator taken to assess the share of imperfect competition is the share of intra-industry trade. Intra-industry trade is trade within a single sector, and is generally assumed to be explained by economies of scale and differentiated products. The share of intra-industry trade in EU trade with Slovenia (68% in 1995)[26] and the Visegrad countries[27] is relatively

[24] Including Emerson et al (1989) and the Cecchini Report.

[25] learning effects

[26] These estimates are taken from Eurostat Statistics in Focus. External Trade 1996, n. 7 and n. 13, and are based on the following index:

Grubel Lloyd intra-industry index = $\frac{(Xi+Mi) - |Xi-Mi|}{(Xi+Mi)} \times 100$

The index is calculated using the SITC divisions 00 to 99. Its value varies between 0 (the two countries are specialised in different product categories indicating inter-industry trade) and 100 (the countries are specialised in the same product chapters indicating intra-industry trade).

high, but the percentage is much lower for trade with the Baltic States.[28]

In general it is assumed that a higher level of intra-industry imports implies less threat to domestic production because if adjustment if necessary it will be carried out at the level of firms within an industry, or even of production lines within a firm. However, more empirical analysis is necessary to see how far this is the case in practice.[29]

In deciding which economic sectors in which CEECs are ready to cope with competitive pressures and market forces in an enlarged Community, a detailed analysis of their economies is therefore necessary. This could take into account progress in the following areas:

- the creation of a stable and competitive economic environment, *inter alia* through the privatisation process and the introduction of an adequate legal framework with regard to property rights, contracts, competition and company law
- the evolution of the banking and financial sectors
- the development of a modern efficient administrative system and a role of the state appropriate to a mixed economy
- restructuring and modernisation of industries in decline such as coal, steel, agriculture and shipbuilding
- success in developing industries characterised by growing demand and high technology which are at the core of an information society
- widening of the industrial base and the diffusion of small and medium enterprises
- demonopolisation and/or the development of a suitable regulatory framework for sectors dominated by former state-owned enterprises, such as energy and telecommunications
- the introduction of measures to encourage R&D and technological innovation
- measures to promote foreign investment

Governments in the CEECs are under considerable pressure from producer interests

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[27] Ranging from 48% for Poland to 65% for the Czech Republic in 1995, according to Eurostat estimates.

[28] 23% for Latvia and 34% for Estonia and Lithuania in 1995, according to Eurostat data.

[29] The distinction between vertical intra-industry trade (involving quality differences) and horizontal intra-industry trade (which is trade in genuinely similar products) might prove useful in this context.

to introduce protectionist measures, and other forms of assistance to enterprises,[30] so care should be taken to resist lobbying activities. As Zielinska-Glebocka (1996) argues, this is a further reason for the importance of coordinating industrial policy with competition policy (see next section) and trade measures. Trade liberalisation is required by the obligations of the Europe Agreements and Uruguay Round, but the CEECs have a certain amount of leeway in interpreting these obligations.[31] On numerous occasions the CEECs have used the various protective clauses allowed for in the Europe Agreements,[32] even though protectionism is unlikely to prove an efficient instrument in promoting increases in competitiveness.

Acceptance of the of the acquis communautaire concerning the Single Market

The 1995 White Paper *Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union* sets out the tasks to be faced for integration of the CEECs into the Single Market.[33] This entails the elimination of physical, technical, fiscal and tariff barriers between participating states.[34] For that purpose the CEECs will have to put into place "legislation and regulatory systems, standards and certification methods compatible with those of the European Union".[35]

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[30] The Hungarian economist, Kornai (1980, 1986) has described the network which linked "the paternalistic state and the firm which is its client" in the central-planning system, and it appears that transition has not been completely successful in breaking down this type of "tutelage" relationship.

[31] As discussed in the section on trade below.

[32] For instance, Poland used general safeguards for balance of payments purposes in 1993 and 1996, and for motor vehicles in 1994. In 1994 tariffs were imposed on telecommunications on the basis of the infant industry argument, and in 1996 protective measures were imposed on petrochemical imports on the basis of the restructuring clause (Zielinska-Glebocka, 1996).

[33] The Single Market is defined as an area without internal frontiers in which the four freedoms (of movement of goods, services, people and capital) are ensured.

[34] One way of eliminating the barriers to movement of goods and services would be to introduce common rules and regulations. However, the detailed, technical legislation that this involves is likely to prove too complex and costly, as well as running the risks of excessive uniformity and bureaucratic interference. To meet this difficulty the Community relies so far as possible on the principle of mutual recognition (established in the famous *Cassis de Dijon* case of 1979), according to which all goods lawfully manufactured and marketed in one member country should be accepted also in other member countries. Exceptions related to public health, the fairness of commercial transactions and the defence of the consumer are permitted.

The introduction of the Single Market also has to respect the principle of subsidiarity whereby legislation at the Community level should only be introduced where the same or a better effect cannot be achieved at a regional or national level.

[35] Conclusions of the European Council at Essen, 9 and 10 December 1994, SN 300/94, p. 13.

Though the list is not meant to be exhaustive, the regulatory alignment of the CEECs to the internal market requires measures with regard to: health, safety and consumer protection; environmental protection; services, including transport, energy, telecommunications and financial services; customs and indirect taxation; competition policy and social policy.

The White Paper sets out the main measures to be taken by the CEECs in each sector of the internal market, and indicates a sequence for the approximation of legislation. EU support for this process was to be provided through the PHARE Programme and through a new technical assistance information exchange office. The timing and priorities in the introduction of measures are left to the CEECs, and adoption of the whole *acquis* is required only after accession (and even then, possibly after a transitional period).

With regard to social policy the aim is to ensure the operation of a "level playing field" and avoid the risk of social dumping. However, Smith et al. (1996, pp. 5-6) argue that social and environmental policy areas should probably not be harmonised prior to accession. To do so is to require the CEECs to accept tighter obligations than existing member states, as in 1989 the UK opted out of the Social Charter and many derogations have been granted for expensive environmental regulations.

The Europe Agreements committed the CEECs to adopting competition policies compatible with those of the Community and this objective was further specified in the 1995 White Paper.[36] In this context external pressure to force measures which are unpopular, but essential to the transformation process, may play an important role. The introduction of effective anti-trust measures is urgently required in the CEECs, where the legacy of central planning has left a concentrated structure of production, and often privatisation of state enterprises has not been accompanied by adequate measures of demonopolisation. The need to bring legislation in line with that in EU countries in areas such as the control of state aids can provide CEEC governments with a strong justification for resisting excessive rent-seeking on the part of producers.

However, the proposals presented in the 1995 White Paper are not always appropriate to the conditions of transitional economies. For instance, the EU rules on restrictions on vertical restraints may prove excessively binding in countries attempting to set up adequate distribution networks. Similarly, the exigencies of privatisation and restructuring may require a flexible approach to controls on state aids (Smith et al., 1996).

[36] The White Paper makes reference to Articles 85, 86 and 90 relating to competition rules, and Article 92 concerning state aids.

A full assessment of the degree of regulatory alignment of the CEECs would require a detailed analysis of the state of legislation in each of the CEECs and is beyond the present scope. However, transposition of Single Market measures into national legislation is incomplete even for the existing EU members and, even where national measures have been introduced in the EU (15), these are often inadequate to ensure the objectives of the Single Market. As a result, implementation of the Single Market Programme is estimated at only about 65% in existing EU member states,[37] and could be as low as 5-15% for the CEECs.

B. The political criteria for enlargement

Article 237 of the EEC Treaty and Article O of the Maastricht Treaty specify that "any European state may apply to become a member". But already twenty years ago, there were clearly other conditions: in April 1978, the European Council declared that "respect for and maintenance of representative democracy and human rights in each Member State are essential elements of membership in the European Communities".[38] In its report on enlargement to the June 1992 Lisbon European Council, the Commission argued that there are "three basic conditions of European identity, democratic status, and respect of human rights".[39]

With regards to the most recent enlargement, there was no doubt that Austria, Finland, and Sweden were democratic and respected human rights. Three countries, Greece, Spain, and Portugal, had previously joined the Community following a transition to democracy. Specific membership requirements for them were not spelled out, but certainly included genuine free elections, the right balance of party strength (pro-democracy parties in the ascendence), and a reasonably stable government. A long negotiation period allowed the Community time to ensure that democracy was being consolidated in the three states.[40]

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[37] Estimates given by an EC Commission representative at a meeting of the Working Group on Eastern Enlargement, Robert Schuman Centre, Florence, 14-15 May 1997. Progress in implementing the Single Market in the EU (15) appears to be particularly slow with regard to public procurement, the recognition of higher education diplomas, and (at least in certain EU states) the liberalisation of air transport, energy, telecommunications, and financial services.

[38] "Declaration on Democracy", Copenhagen European Council, 7-8 April 1978, *EC Bulletin* no. 3, 1978, p. 6.

[39] This is because two essential characteristics of the EU (as stated in article F of the Maastricht Treaty) are democracy and respect of fundamental human rights. EC Commission (1992), p. 11.

[40] Pridham (1994), p. 24. While the Commission discussed (briefly) the transition to democracy in its opinions on the three states, it did so in general terms. But clearly Community membership was linked to the consolidation of democracy in those countries, as stated in the "Opinion on Greek

The CEECs have also applied for Union membership during a process of democratisation and political reform. From the late 1980s, the Community/Union has made trade concessions, aid, and association agreements for the CEECs conditional on progress in economic **and** political reforms, as a means of encouraging the transition. Following this, the Copenhagen European Council in June 1993 accepted that the Central and East European associates could join the Union, but indicated several conditions that prospective members must meet.[41]

There are essentially three "political" conditions. The applicants must have achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. They must be able to take on the obligations of membership, including adherence to the aims of political union. In addition, the Union would have to be able to absorb new members and maintain the momentum of integration.

The conditions are a very important means of influencing the Central and East European associates: the EU thus exerts pressure on the associates to carry out reforms and behave as good neighbours.[42] In this context, providing a date for enlargement would be counterproductive, because enlargement could take place only once the conditions have been fulfilled. But there are problems with applying conditionality, as discussed below. It may not be compatible with political stability, which is, after all, one of the EU's objectives in Eastern Europe.

It should be noted that the CEECs have received less EU financial assistance to help them meet the political criteria than they have to help them carry out the necessary economic reforms. PHARE, through the Democracy Programme and other programmes, has helped to build institutions and civil society in the CEECs. But the amount of aid for such programmes is small: the PHARE Democracy Programme totals ECU 10 million, but PHARE's yearly budget tops ECU 1 billion. This may be changing: in March 1997, the Commission approved new PHARE orientations to channel more funds (30% of total PHARE resources) for strengthening democratic institutions and public administrations in the applicant countries.

Application for Membership", EC Commission (1976), p. 9. See also EC Commission (1978a) and (1978b).

[41] European Council in Copenhagen, 21-22 June 1993, Conclusions of the Presidency, SN 180/93, p. 13.

[42] Mathias Jopp has argued that "conditions for accession, together with a realistic perspective for membership, are the most effective lever for the Union to influence developments in Central and Eastern Europe". Jopp (1994), pp. 58-59. See also Munuera (1994), pp. 91-92.

There is a considerable degree of "subjectivity" in the EU's conditions. The aims of political union are hard to accept if "political union" remains undefined; certainly the current member states would not agree on its meaning. Whether the EU can absorb new members and maintain the momentum of integration is also a matter of interpretation. Judging the fulfillment of these conditions is thus difficult - though opponents of enlargement may use them to try to block the process.

Acceptance of the so-called *acquis politique* is included in the membership obligations, but exactly what it consists of is a bit vague. It certainly includes the Maastricht Treaty (with Common Foreign and Security Policy provisions) and its political objectives,[43] but may be limited to acceptance of the procedures of foreign policy cooperation, not the statements and policies already agreed.[44] This should not be problematic for the CEECs, and could reassure outsiders (particularly those with whom the CEECs have had difficult relations) that the EU's current approach towards a given country will continue along more or less the same lines.

The condition of stable democratic institutions guaranteeing the rule of law and respect for human and minority rights is perhaps less subject to manipulation. But the Union has not publicly listed the factors that would be taken into consideration to judge whether an associate fulfills the "democracy condition".[45] Several "yardsticks" are available. The European Bank for Reconstruction and Development (EBRD) also applies political conditionality and has compiled a list of factors that are relevant for judging the state of democracy in recipient countries (see table 7). Human rights indicators could be found in the European Convention on Human Rights and, particularly, the Council of Europe Framework Convention for the Protection of National Minorities (see table 8).

Obviously, progress on meeting the democracy condition involves not just changing formal constitutions and laws, but following democratic principles and respecting human rights in practice. EU officials, preferably in conjunction with the Council of Europe and the Organisation for Security and Cooperation in Europe, will have to examine the situation "on the ground" in each applicant state to determine the extent to which democratic principles and human rights are being respected.

[43] EC Commission (1992), p. 12.

[44] This was the case with Greece's acceptance of the EPC *acquis*. Nuttall (1992), pp. 173-174. But Anna Michalski and Helen Wallace (1992) argue that the *acquis* seems to include adoption of CFSP shared policies (p. 21).

[45] All ten associates belong to the Council of Europe, whose statutory principles are pluralist democracy, respect for human rights and the rule of law. This could indicate that they have met the democracy condition, at least to a significant extent.

While the extent to which each applicant meets the political conditions is beyond the scope of the present paper, possible problems can be indicated. The Commission has written:

> Minority rights are, in general, protected, but tensions exist in some countries and some difficulties remain in the field of regional co-operation. There is cause for concern about the independence of television and radio in some applicant countries and, while independent judiciaries have been established, judges in some countries lack sufficient training and experience to cope with newly introduced constitutional and legal principles. Non-governmental organisations function independently, although the EU has had to insist on occasion that they remain free from government interference.[46]

Three countries in particular appear to be behind in their fulfillment of the democracy condition: Slovakia, Bulgaria, and Romania. Bulgaria and Romania have recently undergone a period of political instability, but after the most recent elections, seem to be more on track towards democratic stability. Slovakia, however, remains a concern. The EU has had occasion over the past three years to remind Slovakia that it will not join the EU unless it proceeds with democratisation and protects human and minority rights.[47]

The protection of minority rights is perhaps one of the most important factors to be taken into account in assessing the applicant countries. A likely source of instability within the associates is inter-ethnic tension. Disputes and conflicts are possible between them as a result of one state's concern over the treatment of ethnic minorities in a neighbouring state. Disputes over territory could arise in part from minority grievances-states might want to change their boundaries to include more of their dominant ethnic group within their state.[48]

Insisting on the protection of minority rights, though, is problematic. States fear that by granting substantial autonomy to minorities, they create a precedent for separation. By granting rights on the basis of ethnic or other exclusionary criteria, states perpetuate divisions. Minority rights and individual human rights may not be compatible. EU member states themselves are divided over the concept of minority

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[46] EC Commission Spokesman's Service (1996), p. 7.

[47] In November 1994 and October 1995, the EU presented démarches to the Slovak government, reiterating that Slovakia's relations with the EU depended on its progress in implementing democratic norms. In November 1995, the European Parliament threatened to suspend aid to Slovakia because of violations of human and minority rights, and disregard for the rule of law. In February 1997, Commissioner Hans van den Broek urged Slovakia to approve a law on the use of minority languages.

[48] See Walker (1993), p. 45.

rights, with France and the UK in particular more inclined to emphasise individual rights.

Inter-ethnic relations, however, have been difficult within several of the applicant countries, and have been the sources of problems in their relations with each other. Relations between Hungary, Slovakia and Romania have been seriously strained over the treatment of Hungarian minorities, among other issues.[49] In Romania, anti-Hungarian, anti-Semitic and racist parties were close to or part of the government in 1994-1996. In the summer of 1995, the Romanian government blamed ethnic Hungarians for atrocities committed during the 1989 revolution and limited minority language rights. But the new government, in power since November 1996, includes a minister from the Hungarian Democratic Union party. In March 1996 the Slovak parliament passed a law on state language which did not include the possibility that minorities could use their own language in areas where they constitute a substantial part of the population.[50] In Estonia and Latvia, the treatment of Russians living in those countries (with particular respect to the different provisions on citizenship) has prompted Western concern. The treatment of minorities is, then, an important consideration for EU membership and implementation of the Council of Europe Convention principles could be a yardstick for measuring this.

To try to reduce disputes over minorities, the EU has strongly encouraged the East European countries to cooperate with each other, but this is not officially a membership condition.[51] The Pact on Stability in Europe has been by far the EU's most important initiative to foster regional cooperation and the protection of minority rights. This was a series of conferences and roundtables between May 1994 and March 1995, in which the associates (minus Slovenia, which had not yet signed an association agreement with the EU) were urged to conclude good neighbour agreements covering the problems of national minorities and borders, and to set up

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[49] There are approximately 600,000 ethnic Hungarians in Slovakia and 100,000 ethnic Slovaks in Hungary. Romania has between 1.6 and 2 million ethnic Hungarians. Hungary's attitude on the minorities issue has not always been constructive: it has argued that is has a special obligations towards Hungarians living outside Hungary. See "Minorities; That Other Europe", *The Economist*, 25 December 1993-7 January 1994. In 1992-1993, the Commission mediated another dispute between Slovakia and Hungary, over the Gabcikovo dam project on the Danube. See Munuera 1994, pp. 8-11.

[50] See Batt (1996), pp. 29-34.

[51] The multilateral political dialogue between the Community/Union and the associates, initiated in 1992 with the Visegrad countries, clearly was devised to spur regional cooperation. The dialogue developed into the structured relationship, which is likewise a multilateral framework. PHARE aid has been channelled into regional cooperation programs and cross-national projects. But it should be noted that these efforts contrast with and contradict the bilateral framework for economic and political relations set up by the Europe agreements.

regional cooperation arrangements. Although the EU did not explicitly state that participation was a membership condition, many of the associates agreed (reluctantly) to the Pact because they considered it a condition. Hungary and Slovakia reached a good-neighbourly agreement within the framework of the Pact in March 1995, but Slovakia did not ratify it until a year later. Hungary and Romania signed a treaty in September 1996, though this has been controversial in both countries. The Pact still does not contain good-neighbourly agreements between Russia and Estonia or Latvia.

The issue of regional cooperation among the associates remains a concern: even the three countries considered most likely to join the EU in the first wave, the Czech republic, Hungary, and Poland, do not readily or easily cooperate with each other. The three countries and Slovakia did set up the Central European Free-Trade Agreement (CEFTA) in 1992, but tariffs among the CEFTA states remain high.[52] There are several other regional groupings in Central and Eastern Europe that link the associates with EU member states and other non-applicant countries, but the overriding concern of the applicant states remains that of joining the EU.[53] Some associates have claimed that the EU's encouragement of regional cooperation is an attempt to block their accession to the EU because a separate regional grouping could serve as an alternative to EU membership.[54] But EU membership requires that member states cooperate with each other (obviously). The CEECs "will be rather surprised to find that the parallel integration of neighbouring countries with the European centre automatically means close links with each other too."[55] As discussed further below, the state of relations between the applicant countries should be an important consideration in any enlargement decision.

III. Consequences of Enlargement in Stages

A. Institutional implications

The institutional implications of further enlargement are well known. In general, if decision-making procedures are not reformed, a larger EU could result in slower or

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[52] Slovenia joined CEFTA in January 1996; other associates (Bulgaria, Lithuania and Romania), as well as Ukraine, are also to join. See "Concrete Heads", *The Economist*, 16 September 1995, and *European Report* no. 2206, 12 March 1997.

[53] One such grouping is the Central European Initiative, an Italian initiative originally called the Pentagonale.

[54] See Körmendy (1992), p. 248 and Adameic (1993), pp. 24-25.

[55] Balázs (1995), p. 16.

blocked decisions. This would particularly be the case where decisions must be taken by unanimity, for example, in Maastricht Treaty pillars two (Common Foreign and Security Policy) and three (Justice and Home Affairs). This could result in "lowest-common-denominator" decision-making, or a failure to act at all. Greater recourse to qualified majority voting seems to be called for, but is controversial among the current member states, and there are reasons to doubt whether the Central and East European states would accept this.

Many of the Central and East European associates are also new states, arising from the breakup of federations in the early 1990s, or in any case, are states whose borders date only from the end of World War I. "In these circumstances, the symbolic abolition or even the transparency of state borders through integration is a rather sensitive and actual question in Eastern Europe."[56] All new member states must adjust to membership in a "supranational" institution, but this may be particularly difficult for countries which have so recently "regained" sovereignty.

The EU's institutions should be adapted to cope with a larger Union. The number of Members of European Parliament (MEPs) should be limited if the Parliament is not to expand indefinitely (but this could increase the imbalance in the electoral base of MEPs from large and small member states). The number of Commissioners and European Court of Justice judges would also have to be restricted, possibly to less than the total number of member states. The enlargement of the Council, particularly to more small member states, raises questions about the rotating presidency, the relative voting weight of the small member states, and the threshold of votes needed to approve measures by qualified majority.[57] See tables 9 and 10 for an indication of the effects that enlargement could have on the current voting arrangements in the Council. The poorer member states would gain considerable voting power (providing they vote together), which could result in wrangles over the budget in particular.

There is a danger that none or only some of the institutional and decision-making reforms considered necessary will be undertaken, because the current member states cannot agree to do so. Because an enlargement in stages implies that only a few (2 to 5) states would join at a time (and may join different policies with different transition periods), the sense that EU institutions and decision-making procedures must be reformed urgently could be diminished.[58] If this is the case, then the Union could experience paralysis (to a greater extent that critics claim occurs now).

[56] Balázs (1995), p. 15.

[57] These issues have been discussed in EC Commission (1992), pp. 14-16, and EC Commission (1996a), pp. 14-18.

[58] Kirsty Hughes has warned that a slow and gradual enlargement "could result in relatively slow adjustment within the EU itself (which could result in ad hoc development of inappropriate, ineffective structures)..." Hughes (1996), p. 2.

The Amsterdam European Council in June 1997, which concluded the 1996-97 IGC, largely put off tough decisions on reforms. Decisions on the future size of the Commission and the reweighting of the Council's voting arrangements will be postponed until the first stage of enlargement, although there was agreement that the large member states will give up one of their Commissioners if the weights of the votes in the Council are readjusted. If the first stage of enlargement includes more than five countries, this compromise would have to be reconsidered. Furthermore, the limited extent of the institutional reforms agreed by the Amsterdam European Council means that another IGC will be held to prepare for a second wave of enlargement.

EU enlargement will entail changes in the membership of the Western European Union (WEU), the EU's putative "defense arm" since the Maastricht Treaty.[59] Those states that join both NATO and the EU could become full WEU members[60]; those states that join the EU but not NATO could become observers. But the forms of WEU membership may need to be changed, since WEU associate membership (for NATO member states that are not also EU member states) seems to allow for greater participation in the WEU than does observer status (which is, broadly speaking, the status of the neutral EU member states). The new member states, that are not also NATO members, may therefore not be satisfied with observer status. Differing memberships in the EU, WEU and NATO may further complicate - or even block - decision-making in the foreign policy, security, and defense fields.

B. Implications for budgetary expenditures and receipts

The extent and speed of acceptance of the *acquis communautaire* by new members has always constituted a central difficulty for successive EU enlargements. In the case of eastward enlargement the large number of applicants, their relatively low level of income (the increase in EU population would far exceed the addition to GDP as shown in Table 11), and the fact that most CEECs have large agricultural sectors pose particular difficulties. One of the key questions which arises concerns how far enlargement in stages will ease the problem of extending the structural funds and the Common Agricultural Policy (CAP) to the CEECs.

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[59] The Amsterdam Treaty provides for closer EU-WEU ties, but not for a merger of the two organisations.

[60] The current "front-runners" in the queue for NATO membership appear to be the Czech republic, Hungary, and Poland. Slovenia, and, as a very long shot, Romania, may also join in the first wave of NATO enlargement. The Baltic republics are unlikely to join NATO any time soon, given the problems that would raise for relations with Russia.

Additional spending through the structural funds

As Table 12 illustrates, with the exception of Slovenia, the per capita GDP in terms of dollars of the CEECs was below that of the poorest EU (15) member states. When comparing per capita income in the CEECs and EU it is essential to bear in mind the limitations of comparisons of this type. All the CEECs have rapidly growing private sectors, much of which fails to show up in official statistics, though it must be recalled that most EU economies also have substantial "informal" sectors. A second difficulty arises in that the prices of non-traded relative to traded goods tend to be lower in poorer countries. For this reason comparisons of per capita income are often made on the basis of purchasing power parity (PPP). However, as Table 12 shows, even using this measure, per capita income in the CEECs is lower than in the existing EU.

Despite the rapid growth of the CEECs, it appears likely that it will take some years to eliminate the income disparity compared with existing EU member states. Table 13 presents the results of a study carried out by Baldwin (1994), which illustrate the estimated length of the catch-up period under different assumptions concerning real GDP growth.

Table 14 sets out the various estimates of the cost of extending the structural funds to the CEECs. According to Courchene et al. (1993), the financial perspective for the 1994-99 period agreed at the Edinburgh summit entailed a commitment of per capita support to the two poorest countries (Greece and Portugal) of 400 ECU per capita in 1999. Given the "relative backwardness and evident lack of modern infrastructure"[61] of the CEECs, a transfer of 400 ECU per capita would seem a minimum claim. However, if applied to the four Visegrad countries, it would imply an increase in structural spending of 26 billion ECU, while the additional inclusion of the Baltic states, Bulgaria and Romania would raise the structural funds by 54 billion ECU.

Brenton and Gros (1993) estimate the cost of extending structural funds to the CEECs both on the basis of the 1992 rate of aid per capita to the poorest EC country, Greece, and on the basis of the projected 1999 rates per head, allowing for a 43.5% increase in Objective 1 expenditure. The latter estimates are based on the assumption that GDP grows in all countries by 2.5% (i.e. that there is no catching up).

Fayolle and Le Cacheux (1995) provide an alternative estimate which also takes into

[61] Courchene et al. (1993), p. 114.

account levels of unemployment in beneficiary states, and their results are also presented in Table 14.[62]

As Brenton and Gros (1993) point out, accession of the CEECs would lower the average GDP of the Community so some countries which currently benefit from Objective 1 assistance[63] would no longer qualify. According to Brenton and Gros, in order to enable existing beneficiaries to continue receiving aid, the threshold would have to become 92% of the average GDP per capita in an enlarged Community comprising Bulgaria, Romania, the Visegrad countries and Baltic states.

The conditions of partnership and additionality pose further difficulties for extension of the structural funds to the CEECs.[64] Partnership entails cooperation between the Commission and national, regional and local authorities in programming structural spending. The principle of subsidiarity entails that where possible regional authorities should be responsible for the implementation of structural measures. However, the centralised political system which characterised the central planning system means that often the CEECs have little experience of regional devolution of authority.

The principle of additionality is aimed at ensuring that Community funds do not simply replace national expenditure, and requires that Community measures are accompanied by matching funding from the member states of up to 50%. The estimated transfers from extending the structural funds on present criteria to the CEECs would represent an extremely high percentage of the GDP of these countries. According to a study carried out by the Commission (1996b), these transfers would amount to 15% of GDP for Hungary, 18% for the Czech and Slovak Republics, 25% for Poland, and roughly 50% for Romania and Bulgaria.

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[62] Their approach is based on the following formula:
Structural funds per head = ax (Franco-German GDP per head - GDP per head in the beneficiary country) + bx (Franco-German employment rate - employment rate in the beneficiary country).

Two estimates of the coefficients a and b are calculated. The first (hypothesis 1) only considers the structural funds programmed for Spain and Greece for the 1994-99 period. Ireland (which receives a very high level of spending from the structural funds, amounting to 272 per capita in 1992) and Portugal (with its high level of unemployment) were assumed to be special cases and so excluded from the calculations. In the second case (hypothesis 2) all four cohesion countries are taken into account in calculating the coefficients. The coefficients are then applied to the CEECs in order to estimate the additional cost to the structural funds if these countries were members in 1995 (see Table 14).

[63] Objective 1 areas of the EU are defined as those whose GDP per capita is less than 75% of the EU average.

[64] See Brenton and Gros (1993) for a more detailed discussion of this issue.

The results presented here suggest that enlargement in stages reduces the problem of extending structural funds to the CEECs, but does not render it less intractable. The Courchene estimate of 26 billion ECU for the Visegrad 4 is still a huge sum when compared either with the overall EU budget of 59 billion ECU for 1994, or with the total EU PHARE budget of 11 billion ECU for the ten years 1989-99.[65]

The Edinburgh summit fixed the ceiling on contributions of the EU member states to the EC budget at 1.27% of GDP. It appears unlikely that there will be the political willingness necessary to increase that ceiling in the next financial perspective which is due to begin after 1999. Some funds from the 1994-99 package remain unspent and could be re-allocated for structural spending under the next financial perspective. This suggests that structural spending after 1999 could be in the order of 0.46% of the GDP of the EU. A ceiling (possibly in the order of 4% of the GDP of the recipient country) could be placed on the size of the transfer to CEECs joining the EU. However, even with such measures, some reallocation of structural funds away from the present major beneficiaries appears inevitable with enlargement, and is likely to encounter the resistance of the poorer countries of the EU(15).

In order to reduce the discrepancy between transfers under the structural funds for CEECs joining the EU and the far smaller PHARE funds available for CEECs remaining outside the first wave(s) of enlargement, it also seems likely that the pre-accession strategy will be reinforced with the introduction of increased spending on structural measures to flank the PHARE Programme prior to accession. Permitting CEECs excluded from the first round of enlargement to benefit from transfers from the structural funds and assistance for R&D prior to accession would also enable these countries to gain some experience of working with Community policies before joining the EU.

Additional spending on the CAP

There have been numerous studies of the expected impact of extending the CAP to the CEECs on the EU budget, and the result of some of these are summarised in Table 15. The results are generally presented for the Visegrad 4, and (sometimes) the Balkan 2 and the Baltic 3, rather than being broken down by individual country.

Table 16 indicates the land area, agricultural population, level of production, and the extent to which agricultural output is absorbed by the country or exported in the various CEECs. Table 17 shows the percentage increase which would result if 1994

[65] This estimate excludes grants and loans from the EU member states. If these are included the figure for PHARE assistance from the EU rises to 46 billion ECU over the 1990-95 period.

levels of production of some of the principal agricultural products in the CEECs are added to the 1994 level of output of those products in the EU(15). The data in these tables is used to provide a very rough indication[66] of how the addition burden of CAP spending might vary according to the CEEC in question.

What emerges from the discussion here is that enlargement in waves fails to resolve the problem of extending the CAP to the CEECs. The three countries which at present appear to be at the head of the accession list (including the Czech Republic[67]) have sizeable agricultural sectors, so even with the first wave of eastward enlargement fundamental questions concerning the size of transfers and mechanisms to adopt have to be decided.

Expected contributions to the EU budget

CEPR (1992) presents the results of a regression analysis which suggest that GDP is a very good predictor of contributions to the EC budget. Taking the Edinburgh ceiling of 1.27% of GDP as a guide to contributions to the EU budget, and applying this percentage to 1994 levels of GDP in the CEECs, Table 18 provides a very rough guide to the relative contribution of various CEECs to the EU budget.

C. Economic Implications of Enlargement in Stages

The impact of enlargement in waves on trade

As a result of the provisions of the Europe Agreements, a free trade area in manufactured products (and to some extent services) will be in place <u>before</u> enlargement, including both the CEECs which join, and those which do not. The Europe Agreements permit the continued use of "contingent protection", or anti-dumping and safeguard measures[68] in EU-CEEC trade, but during the first years of

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[66] This approach is hugely oversimplified, in particular, because no account is taken of the impact of extending CAP mechanisms to CEECs on the level of production and consumption of agricultural products in the CEECs. Clearly the more relevant indicators will be these values at the time of accession.

[67] The contribution of agriculture in GDP and employment is less in relative terms, but still large in absolute terms.

[68] A safeguard clause in the agreements (Article 24) permits "appropriate measures" to be introduced when a product is being imported in such increased quantities as to cause or threaten to cause serious injury to domestic producers or serious deterioration in the economic situation of a region. In addition there are provisions permitting the introduction of safeguard measures in specific sectors, such as agriculture (Article 15)

Although there is a standstill provision in the agreements (no new customs duties or quantitative restrictions can be introduced once the agreement enters into operation), the CEECs operation of the Europe Agreements the use of these instruments was very limited.[69] As Smith et al. (1996) point out, the EU has made it clear that it will not consider elimination of its commercial policy instruments until the CEECs have applied the *acquis communautaire* with regard to competition policy and state aids fairly comprehensively.

As Tables 19 and 20 show, EU-CEEC trade has been growing rapidly, and there has also been a considerable redirection of much CEEC trade from ex-CMEA countries towards trade with the Community. According to the UN/ECE,[70] CEEC(6) exports to the EU grew by 130% in dollar terms over the 1989-94 period, increasing their share in extra-EU imports from 2.7% to 4.8%.

One of the criticisms of the CEECs is that there has been an asymmetry in the growth of this trade, with their imports growing faster than their exports to the EU. However, this pattern reflects that of overall growth of trade of the CEECs with third countries, and though slower, the increase in their exports to the EU is none the less substantial.

It seems likely that trade liberalisation as a result of the Europe Agreements was only one of the factors contributing to the rapid growth in EU-CEEC trade. Over time the pattern of trade growth appears to have reflected the evolution of real exchange rates

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may introduce "exceptional measures" in the form of reintroducing or increasing tariffs in situations where there are "infant industries or certain sectors undergoing restructuring or facing serious difficulties" (Article 22). Given the transformation process, most industries in the CEECs fall in to these categories, so the CEECs virtually have a blank cheque to re-introduce restrictions.

[69] As Costello and Toledano Laredo (1994) illustrate, anti-dumping cases initiated against the CEECs fell from over 20 per year in the mid-1980s to only 2 cases each in 1992 and 1993. Because EU anti-dumping measures remain in force for 5 years, the CEECs have inherited a number of such measures from their state-trading past. At the end of 1993, 19 such measures remained in force against the CEECs with Poland (6) followed by Romania (5) facing the highest number of anti-dumping actions. In total, only 60 million ECU or 0.32% of EU imports were affected by anti-dumping measures in 1992. The highest share was for Bulgaria (1.24% of all exports to the EC) followed by Romania (0.7%). However, it seems likely that the impact on potential trade, or trade which would take place in the absence of such measures is greater.
At least in the early years of operation of the agreements, safeguard measures were rarely used. In 1992, only two safeguard actions were taken: on Community iron and steel imports from Czechoslovakia, and on imports of sour cherries from, *inter alia*, Poland, Hungary, and Turkey (Costello and Toledano Laredo, 1994).

[70] *Economic Survey for Europe* in 1995-1996. These estimates are based on Eurostat data. If, however, as Drábek and Smith (1995) suggest, Germany is excluded to ensure that the statistics are not being distorted by the inclusion of East Germany in German trade statistics from 1991 the increase is still large though less dramatic (64% for Polish exports over the 1989-93 period as compared with 125% including Germany).

(Halpern and Wyplosz, 1995) and cyclical changes in Western import demand. A number of studies[71] suggest that the increase in East-West trade represents a return to a more natural trade pattern following removal of the artificial distortions of the central-planning system.

There has also been much debate about how far the increase in EU-CEEC trade resulted from the collapse in the CMEA and the need to redirect trade to Western markets in order to eliminate unsold inventories and huge excess capacities. It has been argued that this may have led to "distress" trade in the sense that the CEECs were forced to sell products which would have been destined to Eastern markets at any price that could be obtained in the EU. This need to find new outlets was exacerbated by domestic recession in the ex-CMEA area during the early years of transition.

Table 21 provides a summary of the scale and speed of tariff liberalisation envisaged for the CEEC(6) over the period covered by the Europe Agreements. As can be seen, the provisions are very similar for all six countries, so apart from minor and temporary distortions which may arise because the provisions for the Visegrad countries come into operation a year earlier, trade diversion between these countries is unlikely to result from the removal of tariffs and quotas.

Full integration into the Single Market and acceptance of the Common Commercial Policy (CCP) have to wait until accession (possibly with the application of a transition period). Enlargement in waves therefore means that different groups of CEECs are likely to move from a free trade area to a customs union (by adopting the CCP) and Single Market at different speeds.[72]

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[71] A substantial literature has emerged concerning the eventual level and structure of EU-CEEC trade. Most of these studies (including Hamilton and Winters (1991), Wang and Winters (1991), Baldwin (1994) and Faini and Portes (1995)) use gravity models to predict likely levels of EU-CEEC trade in terms of variables such as the income, population, geographical distance apart and preferential trading arrangements of the two partners. A different approach was used by Collins and Rodrik (1991) who use a trade matrix from 1928 to estimate post-transition trade shares of the CEECS and former Soviet Union.
Various authors have calculated indices of revealed comparative advantage (see for instance, Daviddi (1992), Neven (1994)) in an attempt to predict the long-run product composition of CEEC trade. However, a major shortcoming of this type of approach is that calculation of these indices is based on current trade statistics, which still reflect the choices of the central-planning system and the incomplete nature of transformation rather than any real long-term comparative advantage.

[72] A free trade area entails the member states removing all barriers on trade between themselves, though they retain the freedom to implement different commercial policies towards third countries. In a customs union the member states remove all barriers on trade between themselves and introduce a common external commercial policy (for instance a common external tariff). A single market is a customs unions which also entails free mobility of factors of production.

A major difference between a free trade area and a customs union is that the former requires rules of origin. These may be complex to administer and, the regulatory uncertainty to which they give rise means that market access is conditional (Smith et al. 1996). The CEECs joining the EU (and acceding to the CCP and the Single Market) before others will be at an advantage with regard to rules of origin and contingent protection. As a result there could be some trade diversion between CEECs joining the EU and those left out.

This risk could be particularly great as (with the exception of the Baltic states) CEEC exports to the EU tend to be relatively similar. Petroleum and petroleum products, and other raw materials are an important component of the exports of the Baltic states to the EU, and these are generally characterised by a low level of protection in international trade. In contrast, the exports from the other CEECs tend to be concentrated in the sensitive sectors, which are the sectors most subject to protectionist measures on world markets. As Table 22 shows, despite the dramatic growth in trade and the changes in trade arrangements, the composition of CEEC exports has remained relatively stable over time.

A question which arises is whether, as a result of moving to a high position in the EU's hierarchy of trade preferences, the Associated CEECs could displace other third countries in EU imports of sensitive products. Bucher, Hayden and Toledano Laredo (1994) have carried out a detailed study comparing Community imports from the CEECs with those coming from 9 other groups of country.[73] These authors found that the Mediterranean Basin countries[74] were by far the most similar to the CEECs in their exports to the EU. Of the 25 product groups[75] which comprised more than 1% of EC imports from the Mediterranean Basin over the 1990-92 period, 17 also accounted for 1% or more from the CEECs.[76] On the basis of tests of significance carried out on growth rates of EC imports from the CEECs correlated with growth rates of Community imports from 8 other groups of countries for the 1988-92 period, the three authors find a "weak yes" to the question of whether the rapid growth in imports from the CEECs has displaced imports from the Mediterranean Basin.

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[73] The CEECs, China, the Mediterranean Basin countries, South-East Asia, intra-EC trade, extra-EC trade, EFTA, the rest of OECD, and the rest of the world.

[74] Ceuta-Mellila, Gibraltar, Malta, Turkey, Albania, Yugoslavia, Croatia, Slovenia, Bosnia-Herzegovina, Morocco, Algeria, Tunisia, Libya, Egypt, Cyprus, Lebanon, Syria, Israel, and Jordan.

[75] 3-digit NACE groups.

[76] Among the products were: basic industrial chemicals, electrical goods, textiles, mass-produced footwear, meat fruit and vegetables, and ready-made clothing.

The impact of enlargement in stages on agricultural trade

Predictions concerning the impact of enlargement on agriculture are extremely difficult to make given the uncertainties concerning the form of agricultural policy in an enlarged EU. The effect of enlargement on agriculture will depend on the pre-accession strategies adopted, the future form of the CAP, and the way the CAP is applied in the new CEEC members of the EU.

The EU's pre-accession strategy for agriculture consists essentially of the measures taken to assist agriculture through the PHARE Programme,[77] the agricultural provisions of the Europe Agreements as well as subsequent measures to improve the conditions of access to EU markets. The concessions for agriculture of the Europe Agreements were the least generous of those for any sector,[78] and were the subject of much controversy, in particular when the Community's agricultural trade deficit with the CEECs was transformed into a surplus (see Table 23).

Extensive measures to assist the adjustment of CEEC agriculture prior to enlargement would reduce the discriminatory effect of enlargement in stages on the agriculture of CEECs (temporarily) left out of the EU. Such measures could include further improvements in market access,[79] additional attempts to ensure that EU export subsidies do not lead to market disturbance in the CEECs, and increased assistance for the structural adjustment of CEEC agriculture prior to accession. In the case of Portuguese accession, the Community financed a pre-accession programme of agricultural adjustment, and there would seem a strong case for a similar programme for the CEECs.[80] This could help to overcome the particular difficulties faced by the food industry, and could also be used to further environmental objectives and overall programmes of rural development.

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[77] Over the 1990-1994 period EU assistance for agriculture and rural development amounted to 578 mio ECU mainly through grants of the PHARE Programme (EC Commission, CSE (95) 607, the "Agricultural Strategy Paper").

[78] In most cases the Europe Agreements fixed a quota, rising in time, of EU imports of various agricultural products from the CEECs on which import levies and tariffs are gradually reduced. The concessions were granted on products imported in substantial quantities by the EC from the CEECs during a reference period. For most countries the three years 1988-90 were taken as reference period. Average imports during the reference period were taken as the basic quantity for calculating quotas. In general the concessions entailed a 10% increase in quota each year for the first 5 years, with a levy or tariff reduction of -20%, -40% and -60% in the first three years, subsequently frozen. Tariff and levy concessions granted previously, in particular those under the GSP were to be consolidated.

[79] These could include reduced tariffs, increased tariff quotas, and greater flexibility to ensure higher utilization of quotas, and more transparency and prior warning in the use of safeguards.

[80] For a more detailed discussion, see the "Agricultural Strategy Paper".

It seems likely that CEECs joining the EU will face a transition period for agriculture, but the question remains of what CAP will eventually be extended to the new members. Pressure for further reform of the CAP comes from a variety of directions: the WTO negotiations due to begin in 1999/2000, the new financial perspective of the EU from 1999, and enlargement itself. It appears probable that reform will reflect the shift in emphasis towards rural development and environmental concerns which has emerged since 1988. What seems likely is a deepening of the 1992 MacSharry reform measures[81] and their extension to other sectors. These would entail steps to bring EU support prices closer in line with world agricultural prices, and compensation for farmers through direct income payments. Greater use of direct income payments (including the compensatory payments) would enable rural development and environmental objectives to be furthered. These direct payments would also be "decoupled" so far as possible from levels of production.

What then are the implications of extending this altered CAP only to CEECs joining the EU in the first wave(s)? At present prices for agricultural products at the farm gate are higher in the EU than in the CEECs.[82] Though the adoption of CAP-like price support measures and improvements in quality in the CEECs on the one hand, and reductions in EU support prices on the other, can be expected to narrow this gap, it seems likely that some difference will remain at the time of the first eastward enlargement. The higher prices in CEECs joining the EU will act as an incentive to increase production, and reduce consumption, thereby adding to the supply balance of those CEECs.

Up until 1992 (and in some cases 1993 or 1994), the significant falls in agricultural production and labour force of the CEECs appeared to render the problem of extending the CAP to the CEECs less acute. However, in 1995 there was a turn-around, with grain production in these countries increasing and livestock production levelling out.

Various of the factors (such as the elimination of subsidies or drought in 1991 and 1992, and in some cases also in 1993) which contributed to the dramatic fall in CEEC agricultural production in the first years of transition were of a temporary or

[81] A central element of this reform was a 29% reduction in the target price for cereals and the introduction of direct payments to compensate farmers for their loss of income. In the case of large farmers the compensatory payment was conditional on the set-aside (i.e. leaving idle) of at least 15% of their land. The reform package also included measures for other product groups, such as a 15% reduction in intervention prices for beef, and the use of premiums per head of cattle to compensate farmers and to encourage less intensive means of beef production.

[82] See Buckwell et al. (1995), p. 43.

one-off nature. Other aspects of transition including the fragmentation of farms as a result of privatisation, uncertainty regarding property rights and the high cost of credit could have more protracted negative influence on production. However, it seems probable that when CEEC farmers have weathered the transition process, output will recover in response to improvements in productivity and price increases.

Tangermann (1993) has indicated various possible causes of productivity improvements: better incentive structures as private initiative replaces state and collective farms; improved resource allocation with the removal of central planning; improved technology; better availability of inputs and capital goods; more appropriate feeding practices; better genetic varieties and breeds, and reduced waste and losses.

The increased income in the CEECs is also likely to lead to some recovery of demand, but it is unlikely that pre-transition levels of consumption will be reached. In the central-planning system the figures for food consumption were probably inflated by hoarding in the face of shortages and wastage, as a result of the poor quality of many products.

The recovery of production together with the higher price levels resulting from eventual extension of the CAP to the CEECs joining the EU could lead to an increase in the net agricultural export potential of these countries. According to the EC Commission's "Agricultural Strategy Paper", this increase is likely to be greatest for cereals. In the long run, the net export supply potential for daily products may be lower, while supply and demand for meat in the CEECs could be roughly in balance.

It also seems probable that farmers in CEECs joining the EU will also benefit from higher levels of direct income payments than those in CEECs which do not. There has been some debate about how (or whether) these payments should be extended to the new CEEC members of the EU. At least initially the payments were introduced as compensation for the loss of income resulting from the reductions in price support implied by the MacSharry reform. As the Commission's Agricultural Strategy Paper[83] argues, farmers in CEECs will not experience price cuts, and the application of these payments to farmers alone could increase income disparities (*inter alia* favouring those who have already benefitted from restitution programmes) and create social unrest. There seems a case for using at least part of the money available for compensatory payments on more general rural development programmes. A further difficulty arises from the possible renationalisation of the CAP, with the member states paying for a growing share of direct income subsidies. Given the severe budget constraints in the CEECs this could imply less funds available for agriculture than in existing EU members.

[83] Though the forecasts presented in the Agricultural Strategy Paper are for CEEC(10).

Though the exact amounts will depend on the future form of the CAP and transitional arrangements agreed, the CEECs joining the EU will receive large net transfers for agriculture from the EU budget (see Table 15 above). Ultimately CEECs joining the EU will also benefit from what remains of the Community's system of export subsidies, though the GATT/WTO limits on subsidised agricultural exports could act as a binding constraint on an enlarged EU.[84] This is likely to give them an advantage in competing with farmers from CEECs outside the EU on the markets of third countries and on the markets of the CEECs left out of the first wave(s) of enlargement.

The possibility that firms remaining outside the EU lose their relative competitiveness

At least from the point of view of moving from a free trade association to inclusion in the Single Market, the Eastern enlargement is similar to that of 1995. One of the main arguments advanced in favour of the EFTA countries forming the European Economic Area (EEA) or joining the EU itself was the loss in relative competitiveness that their firms would experience if they were left out of the Single Market. The creation of a wider, less fragmented market as a result of the 1992 Programme would reduce costs and prices in the EU (12).[85] As a result, producers in countries excluded from this process would find it harder to compete not only on the EU market, but also on their own domestic market and in third countries.

In the case of the CEECs the question of expected benefits from participating in the internal market is rendered more complex, as account also has to be taken of their ability to cope with competitive pressures and market forces (see above). None the less, it does seem likely that CEECs participating in the internal market will benefit from an additional stimulus to competition and technical progress, and from the greater scope for exploiting economies of scale.

The way in which the Single Market Programme was presented initially in the 1985 Cockfield White Paper and Single European Act represented a major marketing success. The timetable set out deadlines which fixed precise targets, and focused the attention of politicians and businessmen. At least in the late 1980s, the predictions of an improved economic climate with scope for restructuring of EU industry appeared to become a self-fulfilling prophesy. Would it be possible to repeat this earlier success with the announcement of a clearly-defined, precise strategy for

[84] The GATT Uruguay Round entailed a commitment to cut export subsidies by 21% in volume and by 36% in expenditure terms for all agricultural products, and it seems probable that the future WTO negotiations will entail further obligations of this kind.

[85] See Emerson et al (1989), Venables and Smith (1988), and Baldwin (1989).

enlargement? The style of the 1995 White Paper suggests that it was an attempted step in this direction, but to acquire greater credibility, and to avoid the risk of a differentiated pattern of development emerging among the CEECs, some of the other uncertainties surrounding enlargement would have to be removed.

Although the CEECs will only fully participate in the Single Market after accession, this does not imply that they will not benefit from possible positive effects before then. Integration is an ongoing process and many of the benefits (or drawbacks) will be felt as CEEC policies are aligned to those of the EU. Moreover, Italianer (1995) has shown how much of the reaction to the Single Market Programme in the EU (12) occurred after the policy was announced, and formalised in the Single European Act, and before the 1992 deadline. Similarly, the formal announcement of enlargement could have a positive impact on expectations in the CEECs concerned.

The impact of enlargement in stages on foreign direct investment in the CEECs

Given the scarcity of domestic sources of capital in the CEECs, foreign direct investment (FDI) can play a key role in determining progress in economic transformation. During the early years of transition, inflows of FDI into the CEECs were small and sluggish, but subsequently, as Table 24 shows, they have accelerated sharply. According to World Bank estimates,[86] FDI inflows to the CEECs and former Soviet Republics nearly doubled in 1995, reaching 5% of world inflows compared with only 1% in 1991.

The EU accounts for about three quarters of the FDI stock in Hungary and Bulgaria, two-thirds in the Czech Republic, Poland, Slovakia and Slovenia and just over 50% of the FDI stock in the Baltic States (World Bank, 1996). Inflows of FDI to the CEECs have been heavily concentrated in three countries: Hungary, Poland and the Czech Republic, confirming that FDI is highly selective with regard to location.

FDI may make an important contribution to the transition process in a number of ways. FDI generally involves a transfer of technology, management techniques and of marketing skills. Other firms in the CEECs may imitate these new techniques enabling them to percolate through the economy.

The motives for FDI in the CEECs include the chance to expand into new Eastern markets, the opportunities offered by privatisation, and the possibility of exploiting low production costs. Foreign investors are attracted by the relatively cheap, well-educated labour supply and the nearness of some CEECs to major West European markets. However, the overall economic outlook, the institutional structure and the degree of economic and political stability also play a role in FDI decisions.

[86] World Investment Report, 1996, p.64.

Economic recovery was one of the factors contributing to the rapid increase in FDI since 1995.

Participation in the programme of regulatory alignment set out in the 1995 White Paper, and an announcement by the EU that accession of a particular CEEC was acceptable can therefore play an important role in influencing FDI decisions. The White Paper sets out the steps necessary for progressive adoption of the internal market legislation on issues such as intellectual property, company law, financial services, competition law etc. In this way it provides a guideline of how to create an institutional framework capable of protecting the interests of foreign investors. The announcement that a CEEC is ready to join the EU is likely to be interpreted as a sign of its progress in transition, and may have a positive effect on expectations concerning the future economic performance of that country. The prospect of EU membership may be seen as a guarantee of economic and political stability, and so reassure foreign investors.
It therefore seems probable that enlargement in stages could lead to a redirection of FDI flows towards CEECs joining the EU at the expense of those left out. The tendency of FDI to concentrate in CEECs marked out to join the EU is likely to be reinforced by the high share of FDI flows coming from the EU and the fact most FDI is already attracted by three of the countries which currently seem to top the accession list.

Against this it might be argued that CEECs remaining outside the EU are at an advantage in attracting FDI because of the opportunities to exploit social and/or environmental dumping.[87] Producers within the EU might set up joint ventures or other forms of cooperation with CEEC firms in order to take advantage of such "offshore" conditions. However, the 1995 White Paper specifically calls for regulatory alignment in the field of environmental and social policies, so, insofar as legislative approximation proceeds, there should be less scope for this type of "offshore" activity in CEECs outside the EU.

Baldwin, Forslid and Haarland (1996) illustrate how integration may lead to what they call investment creation and investment diversion. Investment creation refers to the incentives to increase investment within the integrating region, while investment diversion entails the negative effects of integration on investments outside the region.

The three authors provide empirical evidence for the effects of the Single Market

[87] The *sui generis* nature of transition in East Germany suggests that care should be taken in using it as an analogy in this context. Under pressure from trade unions in both East and West Germany, the eastern Länder took on the West German system of collective bargaining, and wage differentials narrowed rapidly. The sharp increase in GDR wages was not matched by productivity rises, and contributed to the dramatic fall in output and employment. At least in certain sectors the CEECs were at an advantage *vis à vis* East German producers as a result of lower wages.

Programme on investments in the EFTA countries and Spain and Portugal, though they warn about the difficulty of interpreting this evidence. This is partly because the investment decision is strongly procyclical, so it may be difficult to distinguish cases of investment creation or diversion from the consequences of asynchronous business cycles. Moreover, expectations play an important role in influencing investment decisions, so the response in investment may occur following the announcement of a policy, and before the measure is actually implemented.

None the less, as Figure 1 in the appendix (which is taken from Baldwin et al., 1996) illustrates, the evidence suggests that the announcement of the 1992 Programme caused FDI creation in Spain and Portugal, and, at least initially, investment diversion in the EFTA countries. The Cockfield White Paper presenting the Programme was published in 1985, and the Single European Act setting out its formal implementation was ratified in 1987. Negotiations for EU membership of Spain and Portugal began in 1980, and were concluded in 1986. Both countries expected to participate in the Single Market Programme and experienced above average FDI inflows in the late 1980s and early 1990s.

Most EFTA countries suffered a decline in their FDI in the late 1980s, but, with the exception of Switzerland, this was halted, possibly as a result of policies being announced to ensure their participation in the 1992 Programme.[88] As Baldwin, Forslid and Haaland (1996) argue, the different policy response of the EFTA countries may help to explain the different trends in their FDI. Switzerland is the only West European country not to have access to the Single Market, and there appears to have been investment diversion. Austria applied for membership in 1989, and the optimism over a favourable outcome was probably reflected in less uncertainty concerning the threat of the Single Market. After a sharp fall, Swedish FDI began to increase from 1990, and the Swedish application for EU membership in mid-1991 may have contributed to this change.

The impact of enlargement on growth

Baldwin (1989) has illustrated how integration may contribute to growth in both the medium- and long-term. According to Baldwin, the medium-term "bonus" is the result of the improved allocation of resources following removal of the barriers.[89] The increase in efficiency will encourage investment, but eventually this higher than

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[88] In 1989 Jacques Delors proposed the creation of the European Economic Area and its implementation began from January 1994, but by then Austria, Sweden and Finland had opted for full EU membership and joined in January 1995. Switzerland rejected joining the EEA in a referendum, and Norway voted against EU membership in 1994.

[89] Even with a one-off increase in output, if savings and investment stay as constant percentages of output they will rise in absolute terms.

normal rate of investment will disappear. With the increased level of capital formation, the capital to labour ratio rises, and the incentive to invest in more capital diminishes and eventually peters out.

Baldwin draws on endogenous growth theory as developed by Romer (1986) to illustrate how trade liberalisation may lead to a long-term growth effect. Continual growth of output per person in the long run requires ceaseless accumulation of factors of production. In order to endogenize growth it is necessary to endogenize investment. The decision to accumulate factors of production will depend on the costs and benefits of investment. Continual accumulation therefore requires that the return on investment does not fall as capital stock rises.[90]

Various explanations of how this may occur have been advanced. Much of the literature relies on the concept of productivity-boosting knowledge capital. For example, a firm may invest in knowledge to increase its advantage vis à vis other firms. The additional profits from exploiting this knowledge represent the return on investment in knowledge capital for the firm. However, the investment will have a spillover effect in increasing the stock of knowledge in the economy. It is assumed that this spillover will increase the productivity of resources used in innovating.

The model developed by Lucas (1988) focuses on the role played by human capital in contributing to growth.[91] Individuals will invest in skills because they expect that there will be adequate capital for their higher skills to be reflected in higher salaries. Firms invest in capital as they anticipate that there will be sufficient skilled workers for the firm to earn a profit. There is a positive spillover as those investing in human capital do not consider the output-boosting effect that their investment will have.

The next question which arises concerns how integration may contribute to long-term growth. The elimination of barriers may facilitate international flows of knowledge. This could reduce the cost of innovation, thereby increasing the private return on R&D and encouraging more resources to be drawn into innovation. At the same time the creation of a larger market could increase the profitability of innovation.

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[90] As Baldwin points out, this creates a problem since either nobody wants to invest (when the costs exceed the benefits), they want to invest infinite amounts (when the benefits exceed the costs) or they are indifferent to how much they invest (when the costs equal the benefits). To avoid this problem it is necessary for the individual to perceive that the return on his investment diminishes as capital stock rises. This is possible if there is a wedge between private and social returns to investment, and the public (i.e. economy-wide) rate of return is not diminishing as total capital stock increases. Knowledge creation and investment in human capital represent different ways of explaining this "wedge".

[91] This could be regarded as a special case of the knowledge capital argument.

In the case of the CEECs integration can contribute to the transfer of knowledge in a number of ways. As shown above, FDI, which is encouraged by the liberalisation of trade and capital movements and by eventual EU accession, may play a crucial role. Regulatory alignment, in particular, in the area of intellectual property rights, which was required by the 1995 White Paper may also prove important. Western assistance through the PHARE programme, with measures such as the European Training Foundation, may facilitate international flows of knowledge. However, there is a risk that enlargement in stages could result in unequal development with regard to knowledge transfer.

Integration could also have a positive effect on financial markets, thereby leading to higher levels of investment and long term growth. In particular, greater competition might encourage more efficiency in financial markets, enabling a reduction in the spread between the return earned by savers, and the costs of funds to investors (Baldwin, 1994). The 1995 White Paper on preparation for inclusion in the internal market has given priority to putting basic legislation with regard to the financial services sector into place in the CEECs, and EU assistance through the PHARE Programme is available for this purpose. One of the aims of the pre-accession strategy should be to ensure that CEECs left out of the first wave of enlargement do not fall behind in the development of their financial markets.

Possible implications of enlargement in stages for the location of industry

One of the main risks of enlargement in stages is that it may lead to a geographically divided pattern of development, with the economic performance of CEECs left out of the enlargement process lagging behind, if not deteriorating in absolute terms. By attaching importance to spacial, or geographical aspects, the "new economic geography" approach developed by Krugman and Venables[92] offers a useful framework for analysing why such polarised development might emerge.

The Krugman-Venables approach involves a kind of circular causality. The possibility of exploiting scale economies is an incitement to the concentration of industry, while trade costs[93] are reduced if firms locate close to large markets. Where firms are concentrated there will be large markets and large markets provide an incentive for firms to locate. The combination of opportunity to exploit economies of scale and reduce transport costs makes for this circular causality.

The approach also attaches importance to the fact that location decisions are very

[92] Krugman and Venables (1990) and Krugman (1991).

[93] Trade costs include transport costs, but also the more general costs of adapting to the local market, which depends on information, culture, distance etc.

expensive to reverse, so expectations play a crucial role. As a result, in deciding where to locate, future policy (or uncertainty about future policy) may be as important as current policy. In a world of multiple equilibria where various outcomes are possible, the credibility of government policy can play a crucial role. By shifting an economy between stable equilibria a small policy change may have large and lasting effects.

According to this approach, factors such as nearness to a large market provide a strong incentive for other firms to locate in that area. This implies that if a CEEC is near to West European development centres, it is likely to have more chance of attracting industry and FDI. In particular, CEECs sharing common borders with the EU (15) may be at an advantage in attracting economic activity, and this effect may be reinforced by linguistic or cultural affinity. As Petrakos (1996) points out, there will be opportunities for transfrontier cooperation in the form of joint ventures, subcontracting, local and regional policy coordination and the expansion of transport and telecommunications infrastructure.

A second likely development suggested by the new economic geography approach is the concentration of economic activity in metropolitan areas such as Warsaw, Budapest and Prague. These cities and their surrounding areas are likely to present advantages with regard to skilled labour, access to (and opportunities for exerting influence on) government offices, the existence of a large urban market, financial services and transport and telecommunications facilities. The economics of clustering, and imperfect information will place small towns and peripheral regions at a disadvantage in attracting industries to locate in their area.

The new economic geography approach emphasises the role that history, accident and expectations may play in the initial decision of a firm to locate in a particular area. As argued above, FDI plays an important part in the transition process. The announcement that enlargement is to take place in waves could cause a concentration of FDI in the capital cities of the CEECs first expected to join the EU, and subsequently that decision would be difficult to reverse. If the decision to leave certain CEECs out of the enlargement process is interpreted as a sign of their greater economic and/or political instability, not only the peripheral regions and small towns, but also the capitals of these countries may lag behind in attracting economic activity.

The literature on the new economic geography also attaches great importance to transportation costs. Only if the transport and telecommunication systems are adequate can industry become footloose. This suggests that by helping to finance infrastructure projects in the CEECs the EU could play an active role in reducing possible negative consequences for CEECs (temporarily) left out of the enlargement process (and for peripheral regions in CEECs joining the EU). There are, however, certain flaws in this argument:

i) At present the funds available for infrastructure projects under the structural funds are far greater than those from the PHARE Programme. To avoid exacerbating differences between CEECs joining the EU and those left out of the first wave of enlargement, such difference in treatment will have to be reduced. In part this will be achieved by the transitional periods which seem likely before the CEECs joining the EU can participate fully in structural measures. However, it is also necessary to introduce an intermediate programme between PHARE and EC policies which involves participation of all CEECs in cost-intensive EC policies such as structural measures prior to accession.

ii) As the experience of the Italian Mezzogiorno suggests, the provision of infrastructure is a necessary but not sufficient reason for the development of a region.

iii) The link between transport costs and the location of industry is not simple and monotonic. There is a risk that improved transport infrastructure enables people to move to where the jobs are faster than the jobs move to people (Petrakos, 1996).

Labour migration

One of the fears in existing EU member states is that with removal of the barriers, large-scale migratory pressures towards the West will emerge. With accession workers in CEECs joining the EU are (eventually) likely to be granted more favourable conditions in searching for jobs in West Europe, than those in CEECs left out of the enlargement process. In order to assess the importance of this advantage, it is necessary consider the possible scale of East-West migration, and its probable effects.

The question of whether (or for how long) freedom of labour movement will be subject to a transitional period after enlargement remains an open question. In the Europe Agreements freedom of movement of people was said to require "phased introduction", though there was a commitment to EC measures to ease the process. A long transition period would help to assuage Western fears concerning migratory pressures, but according some member states (and notably the UK), it would be unacceptable because it run counters to one of the fundamental tenets of the Single Market Programme.

The experiences of Albania, ex-Yugoslavia and the GDR prior to unification[94] are

[94] Following the "fall" of the Berlin Wall in November 1989, immigration from East Germany, reached 340,000 in 1989 and 120,000 in the first two months of 1990 alone. This was a major

sometimes quoted as justification for the fear of mass migration from the East. In these cases the pressure for migration emerged as a result of uncertainty, economic and political collapse and/or ethnic crisis and armed conflict. One of the main aims of the criteria for accession spelled out at the Copenhagen Summit was to avoid prospective EU members sharing these characteristics.

Much of the recent literature suggests that, provided ethnic upheaval and major civil strife can be avoided, migration in an enlarged EU will be on a manageable scale. However, predictions concerning migration are notoriously difficult to make, as a sudden worsening (or improvement) in economic conditions may alter the pressure to migrate substantially. If a hard core of EU members decided to move forward on a faster integration track, pressures to migrate could increase.

Most of the studies of possible East-West migration rely on comparisons with migrations between South and North Europe in the 1950s to 1970s, and with the North American experience. On the basis of such comparisons, the CEPR (1992) study suggests that 5-10% of a given population might be prepared to migrate with wage differences of about 3-to-1. Layard et al. (1992) maintain that East-West migration could amount to some 13 million people over a 15 year period,[95] possibly comprising about 3.3 million ethnic Germans, 4 million from the CEECs and 6 million from the former Soviet Union. These estimates amount to about 3% of the population of origin, and would entail an annual flow of about 0.3% of the West European population.

Faini and Venturini (1994) offer an explanation of why the pressure to migrate may be on a limited scale. Individuals have a preference for living in their own country for social, cultural and linguistic reasons. Migration is an inferior good (and staying at home is the "normal" good) so an individual will only undertake migration when the wage differential is large enough to offset the non-monetary costs of migration.

Migration will also depend on the chances of finding a job, the level of unemployment benefits, the availability of housing, travel costs and information costs. Faini (1995) also argues that *ceteris paribus* countries with a large informal sector tend to be attractive to immigrants because lower skills are generally required for employment. Moreover, aside from border controls, work permits constitute one

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factor determining the speed of the unification process, and the decision to allow wage rate differentials between East and West Germany to narrow rapidly (in the process rendering much of East German industry uncompetitive).

[95] However, the assumptions made by Layard et al. concerning income disparities (10 times higher in West Berlin than in Poznan) appear exaggerated, especially if PPP comparisons are taken into account.

of the main mechanisms for limiting immigration, and the informal economy represents a means of bypassing this control.

With regard to the effects of migration, in the long run it seems likely that unemployment rates are independent of the size of the labour force. In the short run an increase in exogenous migration will "simply shift unemployment from East to West" (Layard et al. 1992, p. 42). However, as unemployment rises in the West, this puts downward pressure on wages, and eventually Western unemployment will revert to its original level. The difficulty lies in assessing how long this process of adjustment will take.

The costs of migration are lower for younger workers and as these are often the more dynamic and skilled workers, an enlarged EU could benefit from the rejuvenating effect on its labour force. However, the home CEEC could lose just the skilled workers (who have generally been educated at public expense) needed for economic reconstruction. CEECs granted freedom of movement by the EU would benefit from remittances sent home by immigrants. Many of those who emigrate subsequently return home, bringing with them Western know-how. *Ceteris paribus* the outflow of labour from such CEECs (where labour abounds) would raise capital/labour ratios in those countries, thereby increasing incomes. Although liberalisation of trade and capital movements should also tend to equate capital/labour ratios and reduce the incentive to migrate, in practice they are unlikely to prove sufficient to remove that incentive.[96]

As argued above, enlargement in stages could place CEECs left out of the first wave(s) at a disadvantage with regard to foreign investment and the competitiveness of their industry. Insofar as this is reflected in larger wage differentials and a slower recovery of employment, pressures for migration from these countries to an enlarged EU (in particular, among the younger part of the labour force) could increase.

D. Implications for security and foreign policy

Enlargement to the CEECs could have implications for the EU's "internal" security. The Union might find that it has imported instability, if there are tensions and disputes between those states that join in the same wave, or if the transition generates societal and political instability even after enlargement. In this respect, it should be reiterated that the conditional promise of enlargement is a "consumable power resource": once it has been fulfilled, the EU loses the leverage it may have had to encourage the applicant state to "behave".

Enlargement to the CEECs will inevitably have implications for the EU's relations

[96] See Layard et al. (1992) for a discussion of this issue.

with outsiders. It will be expensive and absorb EU resources; the EU will probably be even more inward-looking than it has been during the 1990s debates on institutional reform (in the Maastricht Treaty negotiations and ratification process and the 1996-1997 intergovernmental conference). This could mean that external relations/foreign policy is accorded less attention than it is now. The focus of foreign policy will also fall much more on relations within Europe, which could entail a change in foreign policy orientation for member states such as the UK and France, whose international concerns have traditionally been much wider.

The Union's relations with Russia and the former Soviet republics could be affected by enlargement. Firstly, EU enlargement could be perceived by these outsiders as part of a process of re-creating a divided Europe. This perception could be reinforced if the EU sheds its civilian power image and acquires a greater capacity to use military instruments, and/or if the EU, WEU and NATO enlarge to the same countries. NATO will decide in 1997 on which countries it will embrace in a first stage of enlargement, and the process of NATO enlargement will almost certainly occur before the first stage of an EU eastern enlargement. The three "top" candidates for NATO accession are the same top candidates for EU accession, the Czech Republic, Hungary and Poland. If the EU and NATO enlarge exclusively to these three countries in the first stage, the division of Europe could appear to outsiders to be an armed one. While inclusion in one or both organisations would have a stabilising effect, exclusion from both would not. To avoid these potentially negative effects, NATO is considering including Romania and Slovenia in the first round of enlargement, and the first stage of EU enlargement could include Estonia and Slovenia.[97]

Secondly, any new member state "imports" into the Community/Union its own foreign policy concerns and international interests. In the case of the associates, enlargement will inevitably mean that there will be a larger "lobby" concerned with relations with Russia, in particular. The CEECs believe that joining Western security organisations (including the EU and WEU) will provide them with security *vis-à-vis* Russia, an indication of the suspicion and even antagonism between the associates and Russia. Once in the EU, the new member states could push for a harder stance against Russia. Current attempts by the EU to strengthen economic and political relations with Russia could be jeopardised.[98] Likewise, EU relations with other

[97] It should be noted that on 12 June 1997, the US announced that it wanted NATO to enlarge only to the Czech Republic, Hungary and Poland. Reports from the Amsterdam European Council also suggest that Germany wants the EU to enlarge only to the Czech Republic and Poland in the first stage. A limited enlargement, to the same countries, would be more manageable, but the effects on stability could be negative. See Ian Mather, "Romania is the Loser as NATO Embraces New Trio", *The European*, 19-25 June 1997, and "Ancora Lontana la Riforma Politica", *La Repubblica,* 17 June 1997.

[98] The case of relations between Greece, the Community/Union and Turkey should serve as a

"outsiders" in Central and Eastern Europe could also worsen, where there have been problems between them and the acceding CEECs (such as Macedonia's relations with Bulgaria, or Moldova's with Romania).

There is also the reverse problem: Russia may seek to pressure the EU and the new member states, particularly the Baltic republics. Including one of the Baltic states in the first wave of EU enlargement is seen as a way of including them all in the West's "sphere of influence", since NATO will most likely not enlarge to the Baltic republics. Estonia has been mentioned as the first possible EU member state of the three. But Estonia has had serious difficulties with Russia (over, among other issues, its treatment of the Russian minority), and it is not clear how the EU would handle a deterioration in Russian-Estonian relations.

Enlargement in stages will particularly affect relations between the newly expanded Union and those applicant states that have initially been left out. The most stable, prosperous, democratic countries will be allowed to join first, in line with the membership conditions, which means that a negative message would be sent with respect to the associates left out of the first wave. Should economic disparities widen between insiders and outsiders (see section IIC), it may appear that EU membership is a likely prospect only in the distant future. In addition, if the EU proceeds with deepening, the outsiders will have that much more to do to "catch up".

Furthermore, the new member states from Central and Eastern Europe, admitted in the first wave of eastern enlargement, could take a tough stance vis-à-vis the excluded applicant states. They will be able to influence aid and trade decisions with respect to the other associates, the political dialogue with them, and eventual decisions on future waves of enlargement, possibly to the perceived detriment of the outsiders. This is potentially a greater problem where relations between the CEECs have already been strained. It will be difficult for a Union which embraced Hungary to be able to reassure Romania and Slovakia (both unlikely to be admitted in the first wave) that nothing will change after enlargement.

Enlarging first to the most stable countries in Central and Eastern Europe might not help stabilise the other applicants, but rather isolate and alienate them. It is conceivable that nationalist forces in the excluded applicant states become more popular, with negative implications for political stability. The excluded applicants might turn to other countries for support; Slovakia and Bulgaria, for example, have signed economic and cooperation agreements with Russia. This risk should not be exaggerated, however, given the state of the Russian economy (and suspicions of Russian intentions), and the pull of the "West" in general.

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warning of what could happen with relations between the EU and Russia.

With successive waves of enlargement seemingly remote, there would be less outside pressure to proceed quickly with painful or controversial reforms. Of course, reform depends substantially on domestic forces anyway, but the loss of EU influence over the "disappointed" applicant states is a potential side-effect of enlargement in stages. As Kirsty Hughes notes:

> If some countries are possibly looking at a ten to 20 year, or longer, horizon for accession, this - once it is widely recognized in public and political circles - may seriously undermine both direct support for EU accession and any positive and supporting effects of potential EU accession on difficult economic and political reforms.[99]

There may be a trade-off between applying conditionality and political stability. One solution to the problems of the disappointed applicants would be to leave fewer associates on the outside, even if those countries do not meet the EU's membership conditions. Gabriel Munuera has asked, "What degree of divergence in performance should be tolerated in the interests of regional stability?"[100] But if exceptions to the EU's membership conditions are made for some states but not others, then the legitimacy of those conditions will crumble. And why should governments not wholly committed to democracy and the market economy be granted membership in a "club" based on those foundations? Why should states that are not ready be allowed to join?

IV. Managing Enlargement in Stages

The potential problems outlined above indicate that the process of enlargement in stages must be well managed if it is to be successful, and spread security and prosperity eastwards. A key issue is that of the relations between the EU as it is enlarged in the first wave, and the remaining associates. The excluded associates must still perceive EU membership as a real possibility if they meet the Copenhagen European Council conditions. How to achieve this, however, is problematic.

It would be highly impractical to begin accession negotiations with all of the applicants at the same time, even though this would be one way to demonstrate the Union's political will to enlarge to all of the associates. Undertaking ten negotiations with the CEECs (plus Cyprus) would overload the institutions and waste resources.

The EU could consider excluding the possibility that the new member states can veto the membership applications of the remaining associates. This, however, would

[99] Hughes (1996), p. 6.

[100] Munuera (1994), p. 93.

violate Article O of the Maastricht Treaty, which states that applications are to be approved unanimously by the Council and ratified by all the contracting states. An explicit or even implicit statement to that effect could at some future point be challenged legally. As such, it might not fully reassure the outsiders. But even if there were to be such an undertaking, the opposition of current member states to a second or third wave of eastern enlargement could disrupt the Union's business (either intentionally or as a result of tensions between the member states).

An additional membership condition could be explicitly added: all of the associates would have to demonstrate their willingness to cooperate with each other. But this could mean that by being uncooperative, say, by refusing to sign or ratify bilateral agreements, a state could try to hold up the accession of another state.

The Union will instead certainly need to strengthen the framework for relations with the excluded CEECs. Some of the elements of such a strengthened framework have been indicated in this paper.[101] It could include additional targeted financial transfers, aimed at better preparing the CEECs for eventual EU membership. All of the CEECs could participate to some extent in cost-intensive Community policies such as structural measures, R&D and assistance for agricultural restructuring. Measures could be taken to promote further growth in EC-CEEC trade and to ensure that the concessions granted in the Europe agreements are exploited more fully. The CEECs should be granted improved market access for their agricultural products. Private foreign direct investment should be actively encouraged and the International Financial Institutions, including the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD),[102] should continue to support the transition even after the accession of the CEECs to the Union.

Building further ties between the Union and the outside associates, and thus reducing the barriers between them, could help reassure the associates that they were moving "closer" to the Union. The associates already participate in the structured relationship (which includes the enhanced dialogue on CFSP matters)[103] and can apply to

[101] For further suggestions regarding the establishment of a "reassurance framework" for the excluded CEECs, see Susan Senior Nello and Karen E. Smith, *The EU and Central-East Europe: The Implications of Enlargement in Stages.* Report of the First Meeting of the Working Group on Eastern Enlargement, Robert Schuman Centre, Policy Paper nE 97/2.

[102] It is also necessary to ensure that the World Bank continues its activities in CEECs which have joined the EU, and that all CEECs carry on receiving support for macroeconomic stabilisation from the IMF and DGII of the Commission.

[103] The structured relationship provides for regular meetings (once or twice a year) between ministers from the EU and the CEECs in virtually all areas of the Union. Under the provisions of the enhanced dialogue, there are joint meetings at all levels (from heads of state to expert), and the associates can back Troika démarches and CFSP statements, and participate in certain CFSP joint actions.

participate in EU programmes (in fields such as research and technological development, education, energy, and so on).[104] The structured relationship, however, could certainly be strengthened. Frequently meetings have been ill-prepared and do not have a specific objective. Cooperation should instead take place in pursuit of specific aims, and meetings should be prepared adequately and in coordination with the CEECs. Specific aims could include preparation of the CEECs for membership and cooperative projects in areas such as environmental protection, transport, and so on. Furthermore, the excluded CEECs could participate in expert group meetings in specific policy areas,[105] which could help increase the "sense of belonging" to the Union.

V. How to Grasp Diversity: Institutionalise It?

Enlargement, even in successive waves of small groups of countries, will clearly increase diversity within the Union. To cope with this, the Union may have to devise forms of differentiated integration.[106] This could mean that not only the new member states from Central and Eastern Europe (and perhaps the remaining associates) participate in the Union in different ways, but also that increased "flexibility" would extend to the current member states.

There are several possible forms of differentiated integration:

- **long transitional periods** for the CEECs before full membership;

- a **multi-speed EU**, very similar to the first option, but allowing transitional periods for all the member states;

[104] The associates, however, will not sit on the committees that run the programmes, See *European Report* no. 2206, 12 March 1997.

[105] This would entail building on and extending earlier initiatives. For example, in the economic sphere, the Ministers of Finance of the CEECs participate in the Economic and Financial Affairs Council (Joint Ecofin) and in regular meetings on matters of economic policy (such as those of the Subcommittees on economic issues).

[106] On differentiated integration, see Ehlermann (1995); Hughes (1996), pp. 8-10; and Wallace and Wallace (1995).

- **partial membership**, or full participation of the CEECs in only some sectors and policies; and

- a **variable geometry EU**, in which all the member states can choose whether to participate in different policies.

Long transitional periods for the CEECs are undoubtedly necessary, in several areas. Derogations have been very common in the past, and were granted, for example, to Spain and Portugal when they joined the Community. The CEECs would join, either immediately or at a very early stage, the Single Market, the CCP, and the two intergovernmental pillars, CFSP and Justice/Home Affairs. But transition periods (of possibly 5-10 years) will be necessary before the CEECs fully participate in two areas in particular: the CAP and the structural funds. Full participation in the third stage of EMU also appears to be a long-term prospect.

The concept of long transition periods could be translated and extended to all EU member states. A "multi-speed" EU would entail allowing all the member states (not just the acceding CEECs) time before they sign up for certain policies. It implies that the goal for all member states would be that of membership in all aspects of the Union, but that member states may need time to prepare for such membership.[107] For example, some member states have remained outside of some policies, such as the Exchange Rate Mechanism of the European Monetary System, because they were unable to join. Likewise, full participation in the third stage of EMU will be an option only for those member states that meet the criteria.

Forms of partial membership could also be designed. In April 1991, then Commissioner Frans Andriessen proposed creating an "affiliate membership" category for the Central and East European countries. Affiliate members would have "a seat at the Council table on a par with full members in specified areas, together with appropriate representation in other institutions, such as the Parliament".[108] One of the possible options here would be to allow the CEECs to participate first in the CFSP and the Justice/Home Affairs pillar, and to join the Community pillar once their economies had grown, thus lessening the budgetary burden for the EU. In addition, some authors have suggested extending partial membership in the form of exclusion from certain expensive policies, such as the CAP and structural funds, although this would be politically unacceptable, as noted in section IIIC. Partial membership could potentially be a way to include those CEECs that do not join in the first wave of enlargement, in some sectors or pillars of the EU.[109]

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[107] See Ehlermann (1995), pp. 5-7.

[108] Andriessen (1991).

[109] The European Economic Area (EEA) was a sort-of halfway house between full membership and non-membership, although it differs from partial membership in that it does not provide for

A similar option to partial membership could be extended to all the member states. With "variable geometry", all the member states (not just the acceding CEECs) could sign up to different policies on the basis of preference rather than ability. In other words, the member states could choose voluntarily to remain outside certain policies or cooperation frameworks. There are various precedents for this, both within the framework of the EU (the Social Chapter, the probable UK, Swedish and Danish opt-outs of full participation in the third stage of the EMU, or the Danish opt-out of CFSP decisions that have defense implications) and outside it (the WEU, the Schengen agreement). The Amsterdam European Council (June 1997) decided that the new Union treaty will allow "flexibility", but under strict conditions: the member states must agree unanimously that more adventurous states can proceed with deeper integration on certain issues.

Numerous difficulties can arise with partial membership and the extension of variable geometry. Partial members could block agreement in those areas in which they participated, in an attempt to receive further benefits or membership in other areas.[110] There is the risk that a "hard core" of member states, having all signed up for the same policies, decide to proceed with even deeper integration, and other member states find that their options of eventually joining the hard core are excluded.

Too much variable geometry and the problem of external representation and the EU's international actor capability will arise in even more extreme fashion than it does now. Achieving consistency between the external economic relations framework (the Community) and the framework for coordinating foreign policy (CFSP) could become even more difficult if there is a proliferation of frameworks and policy areas with different memberships. For example, the procedure for applying sanctions (first a unanimous common position in CFSP, then a decision taken in the Community framework) could be further complicated because of differing memberships in these frameworks.

As Kirsty Hughes notes, "The question is partly one of balance - some variable geometry may enable flexibility within coherent EU structures (avoiding rigidity) while excessive variable geometry may undermine cohesion and the common base of the EU".[111] Helen Wallace and William Wallace warn that "flexibility could erode

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voting rights for the EFTAns. The EFTAn countries in effect joined the Single Market, but remained unable to participate in the making of decisions in that area. Ultimately, most EFTAns chose instead to join the EU.

[110] It should be noted, however, that this could be a problem anyway: the new member states may demand greater financial transfers once they are inside the EU (and the relative voting power of the poorer member states increases). On this, see Baldwin (1994), pp. 182-190 and 202-205.

[111] Hughes (1996), p. 9.

common interests and undermine collective action".[112] What the core of the Union (in which all member states must participate) consists of would have to be defined, as a minimum requirement for flexibility to function. Furthermore, ways of balancing (voting, resource allocation and budget contribution) rights and obligations would have to be devised.

Some way of incorporating the CEECs, even those that do not join in the first wave, will have to be found that does not destroy the Union or destabilise the European continent. The new member states from Central and Eastern Europe will not be ready to join fully the EU in any event; those CEECs left outside will need to feel that they are still participating in European integration and that full membership of the EU is still a possibility. Given these exigencies, a multi-speed EU for member states, and a framework for closer relations with the CEECs left outside, might be the most viable option.

[112] Wallace and Wallace (1995), p. 15.

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APPENDIX
(containing all tables and figures)

Table 1: Interest rates in selected EU and CEEC countries

	long-term govt bond yield 1997 forecast	long-term govt bond yield 1995	Lending rate	Central Bank discount rate (1995)		Central Bank discount rate (1995)	Lending rate
Maastricht criteria	8.5						
Belgium	5.9	7.34	8.42	3.0	Czech Rep.	9.5	12.80
Denmark	7.8	8.61	11.8	4.25	Hungary	28.0	32.6
Ireland	7.4	8.30	6.56	6.50	Slovakia	9.75	15.64
Sweden	8.2	9.41*	11.11	7.00	Poland	25.0	33.5
Germany	5.7	6.5	10.94	3.00	Slovenia	10	24.85
Portugal	8.0	10.34	13.80	8.93	Latvia	24.0	34.56
Spain	8.0	11.04	10.05	9.00	Croatia	8.5	20.24
Italy	8.8	12.21	12.48	9.00			

*1994

Source: IFS and EIU (Economist Intelligence Unit) as reported in *The Economist* (22 February 1997) for the forecast of long-term bond yield.

Table 2: The Fiscal Criteria and Inflation in the CEECs

	Govt. deficit/ surplus % GDP 1995 (i)	Inflation (average annual increase in CPI) '93 '94 '95	External debt 1994 (est.) $ billion	External debt 1994 as % GDP
Czech Republic	1.8	21 10 9	10.7	28
Hungary	-5.0	23 19 28	28.0	66
Poland	-2.9	35 32 28	42.2	37
Slovakia	-2.2	23 13 11	4.1	30
Slovenia	0	32 13 18	11.1	15
Bulgaria	-7.0	73 87 63	10.5	100
Romania	-4.3*	256 136 32	5.4	17
Estonia	0.3	90 48 29	0.186	4
Latvia	-2.0	109 36 25	0.364	6
Lithuania	-2.0	409 72 40	0.438	7
Croatia	1.7	98 2	2.3	15
Albania	..	23 10	0.925	45

* 1994

Source: Van den Bempte and Theelen, eds. (column i), Eurostat, EBRD, UN/ECE, OECD and World Development Report, Handbook of International Trade and Development Statistics

Table 3: Exchange rates of CEECs' currencies

National currency per US$, annual average, official exchange rates

	1992	1993	1994	1995	1996 (Sept.)
Czech Republic - koruna	28.8*	29.153	28.785	26.451	26.535
Hungary -forint	78.988	91.933	108.160	125.681	156.670
Poland - zloty	1.3626	1.8115	2.2723	2.4250	2.7781
Slovakia - koruna	28.9	30.77	32.045	29.7	30.711
Slovenia - tolar	81.29	113.24	128.81	118.52	134.38
Bulgaria - lev	24.49*	32.71	66.0	70.7	..
Romania - lei	307.97	760.05	1,655.09	2,033.28	3,201.19
Estonia - kroon	12.912	13.223	12.991	11.465	12.040
Latvia - lat	0.736	0.675	0.560	0.528	0.552
Lithuania - talona	1.773	4.344	3.978	4.000	4.000

Source: Van den Bempte and Theelen eds. and International Financial Statistics

Table 4: Changes in GDP, Investment and Unemployment in the CEECs
% labour force

	Unemploy-ment rate 1993	Unemploy-ment rate 1994 est.	Change in total employ-ment 1990-94	Growth of GDP '93 '94 '95	Invest-ment annual % change 1995
Czech Republic	3.5	3.2	-9.6	-0.9 2.6 5.2	
Hungary	12.0	10.4	-26.1	-0.8 2.9 2.0	12.3*
Poland	16.4	16	-14.9	3.8 5.0 7.0	
Slovakia	14.4	14.8	-15.4	-4.1 4.8 7.4	19.0
Slovenia	15.5	14.2	-20.5	1.3 5.3 4.8	8.2
Bulgaria	16.4	12.8	-25.7	-2.4 1.4 2.5	14.3
Romania	10.2	10.9	-8.5	1.3 3.9 6.9	
Estonia	5.0	5.1	-18.6	-8.6 2.4 2.5	10.5
Latvia	5.8	6.5	-14.4	-14.9 0.6 -1.6	
Lithuania	3.4	4.5	-12.0	-30.4 0.9 2-2.5	12.6
Croatia	16.9	17.3	-25.2	-3.7 0.8 -1.5	
Albania	22.0	18	-19.4	10.9 7.4 13.4	

* 1994

Source: Eurostat, EBRD, UN/ECE, OECD and World Development Report, Handbook of International Trade and Development Statistics

Table 5: Indicators of the macroeconomic performance of the CEECs

	public deficit % GDP (1)	foreign debt % GDP* (2)	infla-tion (3)	growth of GDP (4)	unemploy-ment (5)**
Czech Republic	+	+	-	+	+
Hungary	-	-	-	-	+
Poland	+	+	-	+	-
Slovakia	+	+	-	+	-
Slovenia	+	+	-	+	-
Bulgaria	-	-	-	+	-
Romania	-	+	-	+	=
Estonia	+	+	-	+	+
Latvia	+	+	-	-	+
Lithuania	+	+	-	-?	+
Croatia	+	+	+	-	-
Albania	..	+	-	+	-

*Given difficulties in finding comparable data on public debt (the Maastricht criterion), foreign debt has been used here.
** The use of + to indicate an unemployment level lower than the EU average might be somewhat misleading in that a low unemployment rate could be an indication of lack of progress in transition and the fact that much labour remains to be shed.

(1) + public deficit less than 3% GDP
- public deficit more than 3% GDP

(2) + foreign debt less than 60% GDP
- foreign debt less than 60% GDP

(3) + inflation rates no more than 1.5% above the average of the three countries with the lowest inflation rate in the Community
- inflation rates more than 1.5% above the average of the three countries with the lowest inflation rate in the Community

(4) + above EU (15) average of 2.4 for 1995
- lower than EU (15) average

(5) + above EU (15) average 10.9 for 1995
- lower than EU (15) average

Table 6: Progress in Transition in the CEECs

	private sector as % GDP mid-1995	Enterprises			Markets and trade			Financial Institu-tions		Legal reform
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Czech Republic	70	4	4	3	3	4	3	3	3	4
Slovakia	60	3	4	3	3	4	3	3	3	3
Hungary	60	4	4	3	3	4	3	3	3	4
Poland	60	3	4	3	3	4	3	3	3	4
Bulgaria	45	2	3	2	3	4	2	2	2	3
Romania	40	2	3	2	3	4	1	3	2	2
Estonia	65	4	4	3	3	4	3	3	2	3
Latvia	60	2	4	2	3	4	2	3	2	3
Lithuania	55	3	4	2	3	4	2	3	2	2
Slovenia	45	3	4	3	3	4	2	3	3	3

Source: ERBD Annual Report 1995 and Transition Report Update, April 1996

(1) Private sector share of GDP mid-1995

(2) Large-scale privatisation

4 more than 50% state assets privatised; 3 more than 25%; 2 scheme almost ready to be implemented; 1 little done

(3) Small-scale privatisation

4 comprehensive well-designed programme implemented; 3 programme implemented, but design or lack of central supervision leaves some issues unresolved; 2 substantial share privatised; 1 little done

(4) Enterprise restructuring

4 restructuring programme which substantially improves corporate governance in operation; strong financial discipline at the enterprise level; large conglomerates broken up; 3 structures created to promote corporate governance or strong action to break up conglomerates; 2 moderately tight credit and subsidy policy; weak enforcement of bankruptcy legislation; little action to break up large conglomerates; 1 lax credit and subsidy policies weakening financial discipline at enterprise level; few other reforms to promote corporate governance

(5) Price liberalisation and (7) competition

4 comprehensive price liberalisation and price competition; antitrust legislation in place; 3 comprehensive price liberalisation and price competition; 2 price controls remain for some important categories; 1 price controls remain formally controlled by the government

(6) Trade and foreign exchange system

4 few import or export quotas; insignificant direct involvement in exports and imports by ministries and state-owned former trading monopolies; almost full current account convertibility at unified exchange rate; no major non-conformity of customs duties; 3 few import quotas; almost full current account convertibility at unified exchange rate; 2 few import quotas; almost full current account convertibility in principle but with a foreign exchange regime which is not fully transparent (possibly with multiple exchange rates); 1 widespread import controls or very limited and prudential supervision

(8) Banking reform and interest liberalisation

4 well functioning banking competition and prudential supervision; 3 substantial progress on banking recapitalisation, bank auditing and establishment of a functioning prudential supervisory system; significant presence of private banks; full interest rate liberalisation with little preferential access to cheap refinancing; 2 interest rates significantly influencing the allocation of credit; 1 little progress beyond establishment of a two-tier system.

(9) Securities market and non-bank financial institutions
(10) Extensiveness and effectiveness of legal rules on investment

Table 7: EBRD Indicators of the State of Democracy[113]

Free elections
Representative government (executive accountable to the elected legislature or electorate)
Duty of the government and the public authorities to act in accordance with the constitution and law, and availability of redress against administrative decisions
Separation between the State and political parties
Independence of the judiciary
Equal protection under the law, including for minorities
Fair criminal procedure
Freedom of speech, including the media, of association, and of peaceful assembly
Freedom of conscience and religion
Freedom of movement
The right to private property
The right to form trade unions and to strike

113 European Bank for Reconstruction and Development (no date).

Table 8: **Principles in the Convention for the Protection of National Minorities**[114]

Non-discrimination
Promotion of effective equality
Promotion of the conditions regarding the preservation and development of the culture and preservation of religion, language and traditions
Freedoms of assembly, association, expression, thought, conscience and religion
Access to and use of media
Linguistic freedom:
- use of the minority language in private and in public as well as its use before administrative authorities
- use of one's own name
- display of information of a private nature
- topographical names in the minority language

Education:
- learning of and instruction in the minority language
- freedom to set up educational institutions

Transfrontier contacts
International and transfrontier cooperation
Participation in economic, cultural and social life
Participation in public life
Prohibition of forced assimilation

114 Council of Europe (1995), p. 47. The Framework Convention has not yet entered into force, and has no machinery for enforcing compliance with the provisions. Most of the CEECs have signed it.

Table 9

Votes in the EU Council of Ministers			
Current member states	**Votes**	**CEECs**	**Votes115**
Germany	10	Poland	8
France	10	Hungary	5
Italy	10	Czech Rep.	5
UK	10	Slovakia	4
Spain	8	Slovenia	3
Belgium	5	Bulgaria	5
Greece	5	Romania	7
Netherlands	5	Estonia	3
Portugal	5	Lithuania	4
Austria	4	Latvia	3
Sweden	4		
Denmark	3	Total	47
Ireland	3		
Finland	3		
Luxembourg	2		
Total	87		

Table 10

Balance of Power within the Council				
	Total votes	Blocking minority	CEEC vote	Votes of poorest EU states116
EU (15)	87	26		21
EU with Visegrad 4 + Slovenia	112	33	25	46
EU with all 10 associates	134	39	47	68

115 Possible votes based on population. Estimates taken from Baldwin (1994), p. 186.

116 Greece, Ireland, Portugal and Spain. Data are from Baldwin (1994), p. 187.

Table 11: The impact of successive enlargements on the size of the Community*

Year	New entrants	Increase in population	Increase in GDP
1973	From 6 to 9 Denmark Ireland, GB	+33.4%	+32.4%
1981	From 9 to 10 Greece	+3.7%	+2.8%
1986	From 10 to 12 Spain and Portugal	+17.7%	+11.6%
1995	From 12 to 15 Austria, Finland, Sweden	+6.2%	+6.3%
	Accession of Visegrad 3: Czech Rep. Hungary, Poland	+16.6%	+2.3%
	Accession of Visegrad 3 plus Slovenia and Estonia	+17.5%	+3.0%
	Accession of Visegrad 4, Slovenia, Bulgaria and Romania	+27.1%	+3.3%
	Accession of Visegrad 4, Slovenia, Bulgaria, Romania and the three Baltic states	+29.2%	+3.5%

* For reasons of simplicity the accession of Cyprus has not been considered here.

Source: Le Cacheux (1996) for enlargements up until 1995 and own calculations on the basis of statistics from the World Development Report, 1996.

Table 12: GDP per capita in the CEECs and poorest EU member states

	GDP million $ 1994	Pop-ulation million 1994	GDP per head US ($) 1994	GDP per head (PPP, $) 1994
Greece	28,526	10.4	7,700	10,930
Ireland	20,231	9.9	13,530	13,550
Portugal	40,147	3.6	9,320	11,970
Spain	211,542	39.1	13,440	13,740
Czech Republic	36,024	10.3	3,200	8,900
Hungary	41,374	10.3	3,840	6,080
Poland	92,580	38.5	2,410	5,480
Slovakia	12,370	5.3	2,250	..
Slovenia	14,037	2.0	7,040	6,230
Bulgaria	10,199	8.4	1,250	4,380
Romania	30,086	22.7	1,270	4,090
Estonia	4,578	1.5	..	4,510
Latvia	5,817	2.5	2,320	3,220
Lithuania	5,224	3.7	1,350	3,290
Croatia	14,017	4.8	2,560	..
Albania	1,808	3.2	380	..

Source: World Development Report

Table 13: Years necessary to reach a per capita income level 75% of the EU Average

	Assumed annual growth rate		
	3%	4%	5%
Poland	44	33	22
Hungary	35	26	18
Czech Republic	28	21	14
Slovakia	51	39	26
Slovenia	15	11	8

Source: Baldwin (1994)

Table 14: Estimated cost of enlargement for the structural funds
billion 1992 ECU

	Brenton and Gros 1992 rates of aid per head	**Brenton and Gros** estimated 1999 rates per head*	**Fayolle and Le Cacheux** hypothesis 1#	**Fayolle and Le Cacheux** hypothesis 2#
Greece	2.02	3.32		
Ireland	0.71	1.16		
Portugal	1.97	3.24		
EC (12)	16.32	25.46		
Czech Republic	2.08	3.42	6**	5.8**
Slovakia	1.06	1.75		
Hungary	2.12	3.49	4.3	4.2
Poland	7.64	12.57	17.1	17.5
Bulgaria	2.22	3.65	4.2	4.4
Romania	4.76	7.83	12.0	11.9
Estonia	0.31	0.52		
Latvia	0.54	0.88		
Lithuania	0.74	1.12		

* Structural and cohesion funds
** Czech Republic and Slovakia taken together
# See text for explanation

Table 15: Extra Spending on CAP as a result of CEEC accession
billion ECU

	Visegrad 4	Bulgaria and Romania	Accession of Visegrad 4, Bulgaria and Romania	1992 MacSharry CAP reform included	GATT Uruguay Round Agree-ment included
CEPR (1992)	2.4		3.7-7.5	no	no
UK MAFF 1 (1994)	5.4-13.2			yes	no
UK MAFF 2	4.9-14.6	2.6-7.9		yes	no
Anderson and Tyres (1993)	40.5			yes	no
Brenton and Gros (1993)*	3.7-30.9	1.5-10.9	5.2-41.8 CEEC(6) 4.8-13.4 Baltic states	no	no
Tyres (1993)	22-27			yes	no
Baldwin (1994)	11.6	11.6	23.2	no	no
EC Commission (1995)#			CEEC (10) 12.2	yes	yes

*The lower estimates represent the budgetary estimates of accession with 1992 output, while the higher estimates assume full adjustment of agriculture in 1999
Agricultural Strategy Paper, CSE (95) 607

Source: Buckwell et al. (1995) and EC Commission

Table 16: Basic data on agriculture in the CEECs 1993

	agric. area (mio ha)	Agri-cultural GDP ECU billion	Population in agric. 1994 million	Net agric. exports in US $ million 1995
Bulgaria	6.2	0.9	0.9	453*
Czech Rep.	4.3	1.0	1.4**	-488
Slovak Rep.	2.4	0.6		-209
Hungary	6.1	2.2	1.0	1362
Poland	18.6	5.2	6.1	-487
Romania	14.7	5.5	3.4	-252*
Slovenia	0.9	0.6	..	-469
Estonia	1.4	0.2	1.5	-37
Latvia	2.5	0.3	..	-6*
Lithuania	3.5	0.3	..	253*
CEEC (10)	60.6	16.8		
EU(15)	138.1	154.7	18.1	
CEEC(10)/ EU(15)	44%	10.8%	29% (total popul.)	

*1994 **Czechoslovakia, 1994

Source: EC Commission (1995) Agricultural Strategy Paper, Eurostat, World Development Report, FAO and Tarditi et al. (1995)

Table 17: CEEC share of production of various products in the enlarged EU total (1994)*
(crop production in 1000 tonnes, and livestock in 1000s)

	cereals	cattle	beef and veal	butter	dry whole milk
Bulgaria	3.7%	0.9%	1.2%	0.1%	0.1%
Czech Republic	3.8%	2.7%	2.2%	4.1%	6.5%
Hungary	6.8%	1.3%	0.8%	1.0%	0.4%
Poland	12.3%	9.7%	5.7%	9.5%	8.3%
Romania	9.9%	4.6%	4.2%	0.8%	0.9%
Slovakia	2.1%	1.2	0.4%	0.9%	0.5%
Slovenia	0.2%	0.6%	0.5%	0.1%	0.2%
Estonia	1.9%	0.6%	0.8%	1.1%	1.7%
Latvia	0.5%	1.3%	0.8%	1.8%	0.5%
Lithuania	1.3%	2.1%	2.2%	3.0%	1.3%
Albania	0.4%	0.7%	0.3%	0.1%	..
Croatia	1.5%	0.7%	0.4%	O.1%	..

Source: Own calculations on the basis of FAO data

Percentage increase in EU (15) production on the basis of 1994 output levels

Table 18: Estimated relative contributions to the EU budget
million $

	Contribution to EU budget, estimated at 1.27% of 1994 GDP in US $
Czech Republic	450
Hungary	525
Poland	1176
Slovakia	157
Slovenia	178
Bulgaria	127
Romania	382
Estonia	58
Latvia	74
Lithuania	66
Croatia	178
Albania	23

Source: Own calculations on the basis of data from the World Development Report 1996

Table 19: EU-CEEC trade

	EU Exports					EU Imports				Trade balance	
	1989 bio ECU	1994 bio ECU	1995 bio ECU	1995 Share	95/ 94 % Var.	1989bio ECU	1994b io ECU	1995 bio ECU	95/ 94 % Var.	1995 Share	1995 bio ECU
Czech Rep-ublic	2.39*	7.93	10.12	20.5%	27.7	2.56*	6.37	7.86	23.5	18.8%	2.26
Slov-akia		1.79	2.69	5.5%	50.1		1.87	2.62	39.6	6.3%	0.08
Hung-ary	2.99	6.16	6.77	13.7%	10.0	2.59	4.96	6.50	31.9	15.6%	0.27
Poland	3.95	10.82	13.50	27.4%	24.7	3.36	9.11	11.1	21.9	26.6%	2.40
Slov-enia	..	3.67	4.38	8.9%	19.1	..	3.42	3.78	10.6	9.1%	0.59
Bul-garia	1.5	1.67	1.87	3.8%	17.2	0.46	1.34	1.76	31.4	4.2%	0.11
Rom-ania	0.69	2.65	3.55	7.2%	34.2	2.23	2.51	3.26	30.1	7.8%	0.29
Est-onia	..	0.31	0.45	0.9%	46.2	..	0.27	0.43	62.9	1.0	0.02
Latvia	..	0.49	0.63	1.3%	28.8	..	0.72	0.87	18.0	2.1	=0.24
Lith.	..	0.72	0.83	1.7%	14.5	..	0.73	0.88	17.5	2.1	-0.05
				100%						100%	

Source: Eurostat

Table 20: Percentage of total CEEC's trade accounted for by EU

	Exports			Imports		
	1989	1992	1995	1989	1992	1995
Czecho-slovakia	25.7	49.5		17.8	42.0	
Czech Republic			55.2			56.4
Slovakia			37.4			34.7
Hungary	24.7	49.5		28.5	42.4	
Poland	32.1	55.6	70.0	33.8	53.1	64.7
Slovenia			67.2			68.9
Bulgaria	6.7	30.8	37.2	16.5	32.6	38.0
Romania	26.7	32.5	54.0	6.1	37.5	50.1
Estonia						
Latvia			41.4			39.4
Lith.			36.2			53.4

Source: Bofinger, 1995, who uses UN/ECE data for 1989 and 1992 percentages and own calculations on the basis of UN/ECE for 1995.

Table 21:Tariff reduction envisaged by the Europe Agreements as modified by the Copenhagen Summit

	MFN 1992*	GSP 1991#	QR %**	1992	1993	1994	1995	1996	1997	1998
CSFR	6.8	4.4	22.9	2.1	:	1.4	0.7	:	0	0
Hungary	7.5	4.5	25.5	2.5	:	1.9	1.2	:	0	0
Poland	6.4	4.0	19.2	2.4	:	1.7	1.1	:	0	0
Romania	8.9	6.2	27.9	:	4.8	:	3.6	2.2	:	0
Bulgaria	7.2	5.2	32.9	:	3.0	2.3	1.6	:	0	

*MFN duty rate weighted by eight-digit imports within each NACE sector
GSP duty actually paid
**Quantitative restriction, import coverage ratio, 1990

Source: Costello and Toledano Laredo (1994) and Moebius and Schumacher (1994)

Table 22: Commodity Concentration in exports to the EU

	Share of the first five commodity groups 1989	1992	1994	first five commodity groups 1994*
Czecho-slovakia	34.6	37.1		
Czech Rep.			33.4	electrical machinery (77), iron and steel (67), road vehicles (78), articles of apparel (84), manu. of metals (69)
Slovakia			42.5	iron and steel (67), articles of apparel (84), textile yarn, fabrics (65), non-metallic mineral manufactures (66), road vehicles (78)
Hungary	39.4	40.0	39.8	articles of apparel (84), medical and pharmaceutical products (54), meat and meat preparations (01), power-generating machinery and equipment (71), iron and steel (67)
Poland	36.4	37.7	43.1	articles of apparel (84), non-ferrous metals (68), furniture (82), road vehicles (78), coal and coke (32)
Slovenia	-	50.2	48.2	road vehicles (78), articles of apparel (84), electrical machinery (77), furniture (82), manu. of metals (69)
Bulgaria	35.4	39.7	42.3	articles of apparel (84), non-ferrous metals (68), iron and steel (67), footwear (85), textile yarn, fabrics (65)
Romania	70.2	66.9	65.3	articles of apparel (84),furniture (82), footwear (85), iron and steel (67), non-ferrous metals (68)
Estonia	-	58.6	36.5	metalliferous ores and their metal scraps (28), road vehicles (78), petroleum and petroleum products (33), fertilizers (56), non-ferrous metals (68)
Latvia	-	78.4	76.7	petroleum and petroleum products (33), cork and wood (24), articles of apparel (84), metalliferous ores and their metal scraps (28),non-ferrous metals (68)
Lithuania	-	79.2	66.4	petroleum and petroleum products (33), articles of apparel (84), metalliferous ores and their metal scraps (28), fertilizers (56), cork and wood (24)
EU total (extra-EU imports)	29.7	31.5	29.4	petroleum and petroleum products (33), office machines and automatic data processing machines (75), articles of apparel (84), road vehicles (78), misc. manu articles (89)

* two-digit product group codes, SITC Rev.3

Source: UN/ECE whose calculations are based on COMTRADE statistics

Table 23: CEEC-EU Trade in Agricultural Products
million ECU

	1989	1990	1991	1992	1993	1994
			Exports to EU			
Poland	979	1198	1174	1032	896	959
Hungary	910	867	1089	1005	866	964
Czech Republic	267	286	295	326	271	305
Slovakia	267	286	295	326	52	62
Romania	120	49	90	91	97	119
Bulgaria	160	182	223	214	198	217
CEEC (6)	2436	2582	2871	2668	2380	2626
			Imports from EU			
Poland	826	678	1104	1037	1196	1207
Hungary	151	155	216	299	439	556
Czech Republic	191	174	306	486	483	627
Slovakia	191	174	306	486	131	149
Romania	84	280	260	352	342	203
Bulgaria	112	98	166	142	239	279
CEEC(6)	1364	1385	2052	2316	2830	3021
			Trade balance			
Poland	153	520	70	-5	-300	-248
Hungary	759	712	873	706	426	408
Czech Republic	76	112	-11	-160	-211	-322
Slovakia	76	112	-11	-160	-79	-87
Romania	36	-231	-170	-261	-245	-84
Bulgaria	48	84	57	72	-41	-62
CEEC (6)	1072	1197	879	352	-450	-395

Source: Eurostat

Table 24: FDI Inflows to the CEECs
million of dollars

	FDI Inflows 1994	FDI Inflows 1995	Stock 1995	FDI inflows per capita 1995 ($)	FDI stock as % GDP 1994
Czech Republic	878	2500	5008	242.8	7.0
Hungary	1144	3500	9934	346	15.6
Poland	1875	2510	7389	65.4	5.1
Slovakia	203	250	1140	46.7	7.2
Slovenia	84	130	438	66.8	2.4
Bulgaria	106	135	398	15.4	2.6
Romania	340	373	924	16.3	1.9
Estonia	215	188	646	122.9	10.0
Latvia	215	250	539	97.8	5.0
Lithuania	31	50	103	13.5	1.0
Croatia	98	85	337	18	2.4
Albania	53	70	200	20.3	7.2

Source: World Bank, Investment Report 1996 and UN/ECE *Economic Survey of Europe* in 1995 and 1996

Figure 1

Source: Baldwin (1996)