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Economic Effects of EU Enlargement: Prospects and Challenges

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ECONOMIC EFFECTS OF EU ENLARGEMENT: PROSPECTS AND CHALLENGES

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Introduction

From the outset, opening up the borders was a striking symbol of the European Union ("EU"). The break-up of those barriers, which eventually led to the creation of the common market, remains a central characteristic of the EU.[1]

Today, on the verge of the most comprehensive enlargement in EU history, this hallmark of the dissolution of borders reaches a new dimension. With the accession of eight Central and Eastern European countries ("CEEC"), Cyprus, and Malta, the EU is transformed from a Western European post-war community to a union with a truly pan-European aspiration.[2]

No doubt, the enlarged EU will be more heterogeneous and diverse than the present EU of fifteen member states ("EU 15"). The new and the old member states will differ—at least in the short-term—in their living conditions and their needs, in their scope of political action, and in their administrative capacity. These differences constitute a major challenge to European policy makers, be it in the field of economy, where large discrepancies of income and wealth have to be overcome, or in the field of institutional reform, which is meant to ensure the smooth running of the political decision-making process in the EU.

The assessment of the economic effects of the eastward EU enlargement requires a holistic approach, not a mere fiscal calculation oriented only towards the implications on the EU budget. The enlargement process will lead to more economic growth, innovation, and employment, and will outweigh the fiscal costs substantially. The economic growth induced through the integration process in the accession countries contributes to the political stabilization in these countries, thereby minimizing the risk of potentially high costs due to

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[1] *See* Josef Janning, *Europe—The Future of the Union*, DEUTSCHLAND MAGAZINE 36-40 (December 2001/January 2002); *see also* www.cap.uni-muenchen.de, which contains a wide selection of papers on EU expansion.

[2] *See* European Union, *Enlargement - A Historic Opportunity*, *at* http://europa.eu.int/comm/enlargment/intro/index_en.htm (last visited Nov. 23, 2003) [hereinafter *Enlargement – A Historic Opportunity*].

instability and internal conflicts (as, for instance, in the Balkan region).[3] Through the enlargement, the increased political weight of the EU in international organizations such as the World Trade Organization or the United Nations will produce further positive economic effects.[4] The opening of new markets in the CEEC also constitutes a challenge to the economy in the EU 15. It entails an improved allocation of resources as a result of more trade, investment and labor migration. In the end, more wealth is created and the competitiveness of the EU in the global arena is strengthened as well.[5]

Effects on the Real Economy

Trade

Trade effects, with the exception of those to the agricultural sector, have already been anticipated, largely through the existing EU association agreements.[6] The past decade has seen a significant increase in trade volume.[7] EU 15 exports into the CEEC increased an average of fifteen percent annually between 1988 and 1999, and CEEC imports into the EU 15 increased by twelve percent annually.[8] Without the perspective of a future accession, this impressive trade upswing could not have been possible. At the same time, the composition of trade shifted from mainly agricultural products to manufactured goods like machinery and automobiles.[9] The share of the CEEC in overall EU foreign trade (so called extra-EU trade) amounts to roughly ten percent.[10] On the other hand, an average of sixty-eight percent of the CEEC exports and sixty-two percent of their imports go into or come from the EU.[11] This shows a radical reorientation away from the former trade among the Council for Mutual Economic Assistance members toward the EU.

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[3] *See* European Union, *Enlargement: Basic Arguments*, *at* http://europa.eu.int/comm/enlargement/arguments/index.htm (last visited Sept. 25, 2003) [hereinafter *Enlargement: Basic Arguments*].

[4] *See Id.*

[5] *Id.*

[6] *See* European Union, *Europa: The European Union On-Line*, *at* http://europa.en.int/comm/enlargment/pas/europe_agr.htm (last visited Sept. 26, 2003).

[7] Directorate Generale For Economic and Financial Affairs, European Commission, *Enlargement Papers: The Economic Impact of Enlargement* 5, *at* http://europa.eu.int/comm/economy_finance/publications/enlargement_papers/enlargementpapers04_en.htm (last visited Sept.26, 2003) (discussing investment in the CEEC) [hereinafter *Enlargement Papers*].

[8] *Id. at* 21.

[9] DRESDNER BANK AG, THE CHALLENGE OF EU ENLARGEMENT: SEIZING GROWTH OPPORTUNITIES, PUSHING AHEAD WITH REFORM 36 (July 2001).

[10] In contrast, the US share is twenty-two percent. *See Enlargement Papers*, *supra* note 6, at 23.

[11] *Enlargement Papers*, *supra* note 6, at 22.

Investment

Foreign Direct Investment ("FDI") has contributed decisively to the modernization and expansion of the outdated capital stock in the CEEC, thereby ensuring a sufficient capital inflow to counterbalance the high current account deficit.[12] In addition, this FDI flow implies a considerable transfer of know-how.[13] Globally, the CEEC attract the highest FDI in terms of percentage of gross domestic product ("GDP"), which from 1995 to 1999 averaged four percent, with an increase to five and one-half percent in 2000.[14] The EU contributed on average sixty percent to the FDI inflow. The highest rate was for the Czech Republic at ninety-five percent.[15]

The structure of FDI suggests that fifty percent is allocated to non-tradable goods or institutions, primarily infrastructure and banks; another big share goes to the improvement of market access in the CEEC.[16] A further increase of FDI will occur with the accessions in 2004 due to the ongoing convergence of law systems, economic structures, financial sectors, and administrations. This is of particular importance for small and medium-sized enterprises and for geographically more distant EU member states like Spain.

Migration and Labor Markets

In both the short and long-term, positive effects of accession will outweigh the costs of transition. The integration of a qualified work force into the EU market, especially in sectors where there is a need for additional labor such as the information technology sector, will have a stimulating effect and will ultimately trickle down to the demand for less qualified work. Indeed, the growth impetus from accession countries and trade surpluses vis-à-vis the CEEC are already creating new jobs in the EU 15.[17] In the short-term, regional and structural difficulties might affect labor markets, particularly in the member states close to the CEEC.[18] Generally speaking, there will be no drastic, comprehensive migration movements; rather, there will be a moderate flow of workers westward. It is forecast that sixty percent of migrant workers will move to Germany and about ten percent to Austria.[19] The average annual inflow of

[12] *Id.* at 24.

[13] *Id.*

[14] Jaime Turrion & Carmela Martin, *Eastern Enlargement of the European Union And Foreign Investment Adjustments* 3-5, *at* http://ideas.repec.org/p/eeg/euroeg/24/html (last modified Oct. 3, 2003).

[15] *Enlargement Papers, supra* note 6, at 26.

[16] *Id.* at 24.

[17] *See Enlargement: Basic Arguments, supra* note 2.

[18] *Enlargement Papers, supra* note 6, at 26-27.

[19] *Id.* at 37.

workers into Germany and Austria is estimated at roughly 300,000 persons.[20] Therefore, a transitory arrangement has been negotiated to restrict the free movement of the labor force from the CEEC.[21] The arrangement envisages a phased transitional period of up to seven years, during which the member states will inform the European Commission whether they wish to continue applying their national arrangements or EU law.[22] The latter is to be generally applied five years after accession.[23] However, a member state may maintain its national arrangements for a maximum of two additional years should there be a major disruption to its national labor market or the threat of such a disruption.[24]

Repercussions on EU Policies

The enlargement process will increase reform pressure in vital, yet cost-intensive, fields of EU policy, particularly the Common Agricultural Policy ("CAP") and the structural policy, which together absorb around eighty percent of the EU budget.[25] Concerning CAP reform, an agreement was reached at the European Summit in Brussels in October 2002 fixing the ceiling for the 2007–2013 budget period for annual market regulation payments, as well as direct payments, at the level expected in real terms for 2006 (so-called containment), with a one percent annual fixed compensation for inflation.[26] In this way, financing the additional costs for the new member states will be offset by savings made by all.

Discrepancies in economic development among new and old members are substantial.[27] Most of the regions eligible for structural fund payments will be located in the new member states.[28] In order to finance the necessary structural

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[20] TITO BOERI, HERBERT BRÜCKER ET AL., EUROPEAN INTEGRATION CONSORTIUM (DIW, CEPR, FIEF, IAS, IGIER): THE IMPACT OF EASTERN ENLARGEMENT ON EMPLOYMENT AND WAGES IN THE EU MEMBER STATES (2000), *available at* europa.eu.int/comm/employment_social/ employment_analysis/ report/ex_summary_en.pdf.

[21] *See* Documents concerning the accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic to the European Union, 2003 O.J. (L 236) 17, *available at* http://europa.eu.int/eur-lex/en/archive/2003/l_23620030923en.html.

[22] Europa, *Enlargement: Negotiations of the Chapter 2, at* http://europa.eu.int/comm/enlargement/negotiations/chapters/chap2/index.htm.

[23] *Id.*

[24] *Id.*

[25] Europa, *General Publications: EU at a Glance, at* http://europa.eu.int/comm/publications/ archives/booklets/eu_glance/16/txt_en.htm#3.4.

[26] The European Union in Australia, *Results of the Brussels European Council, 24-25 October 2002, at* http://www.ecdel.org.au/pressandinformation/EurCouncil25Oct.htm.

[27] *See* Europa, *Regional Policy, at* http://europa.eu.int/comm/regional_policy/intro/regions8 _en.htm.

[28] *Id.*

adjustments, foremost in the area of infrastructure, the "old" EU has to generate substantial savings. However, the absorptive capacity of the CEEC must also be taken into consideration. Structural adjustment aids above the level of four percent of GDP cannot be used appropriately and efficiently anymore.

Financial means for EU enlargement are sufficient, provided that direct payments to farmers in the CEEC will be restricted. The figures and shares for the 2007–2013 budget framework will be negotiated among old and new member states in 2006. The contributions of the accession countries to the EU budget will be rather moderate; the CEEC will presumably be net receivers of EU funds for a number of years.[29]

Economic Growth

The accession perspective induced in the CEEC a sustainable and stable growth rate in GDP, in contrast to stagnation or even real income losses during the beginning of the transformation process after 1989.[30] According to the European Commission, the eight CEEC will enjoy a growth rate between four and one-quarter to five percent annually from 2005–2010, whereas the growth rate without accession would be just three percent annually.[31] However, the adjustment process to the EU average per capita GDP will be a lengthy one. In 1999, the CEEC average per capita GDP was forty-three percent of the EU 15 average. It is estimated that the CEEC will reach a level of forty-nine percent of the EU 15 average in 2010, and only after twenty-two years will it reach seventy-five percent.[32]

For the EU 15, only very moderate effects on the growth of GDP are expected.[33] The cumulative effects from 2000–2009 will be in the range of an additional one-half to seven-tenths percent as a percentage of GDP.[34] Nevertheless, EU enlargement provides in the short and long-term:

- a stable domestic market (economies of scale);
- higher competitiveness of European companies in a global economy; and
- greater weight of the EU in determining the framework for the international economy.

What Next?

The signing of the Accession Treaty with the ten accession countries will take

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[29] *See* Europa, *Enlargement: Frequently Asked Questions, at* http://europa.eu.int/comm/enlargement/faq/faq2.htm#costs.

[30] *Id.*

[31] *Enlargement Papers, supra* note 6.

[32] DRESDNER BANK AG, THE CHALLENGE OF EU ENLARGEMENT: SEIZING GROWTH OPPORTUNITIES, PUSHING AHEAD WITH REFORM 50 (July 2001).

[33] *Enlargement Papers, supra* note 6.

[34] *Id.*

place in Athens on April 16, 2003.[35] This will be followed by a ratification process in the accession countries and the member states.[36] In the accession countries, with the exception of Cyprus, there will also be referenda.[37] Finally, on May 1, 2004, these ten countries will accede to the European Union in time to take part in the elections of the European Parliament in June 2004.[38]

[35] The Treaty of Accession was signed in Athens on April 16, 2003 by the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, Slovakia, and existing member states of the EU. *See* Treaty of Accession *at* http://europa.eu.int/comm/enlargement/negotiations/treaty_of_accession_2003.htm (last visited Oct. 1, 2003).

[36] *Id.*

[37] *Id.*

[38] *See Enlargement- A Historic Opportunity*, *supra* note 1; *see also* Seville European Council, Presidency Conclusions, Sec.II para 18 (2002), *at* http://europa.int/counciI/off/conclu/.