Student Economic Review, Vol. 17, 2003, pp. 109-115

EASTERN ENLARGEMENT OF THE EUROPEAN UNION: LESSONS FROM THE PAST AND THE ECONOMIC IMPACT

BY ALAN DE BROMHEAD

Junior Sophister

Introduction

In December of 2002, in the Danish capital Copenhagen, the future of the continent of Europe was changed forever. Ten countries, Poland, Hungary, the Czech Republic, Slovakia, Slovenia, Latvia, Lithuania, Estonia, Cyprus and Malta, were invited to join the European Union in the summer of 2004. Europe, for fifty years divided between east and west, would finally be reunited; but at what cost? Would Europe prosper or be ruined? It is clear that the prospect of a twenty-five member EU poses many questions. The purpose of this piece is to try to shed light on the important issues surrounding the enlargement process and come to some conclusions regarding its likely impact on the economy of the Union. We will also examine past enlargements of the EU, in particular the 1980s Southern enlargement involving Spain, Greece and Portugal, as a benchmark by which to make predictions regarding the likely effects the wave of current enlargement will have.

Lessons from the Past: Uncharted Waters or Just Another Enlargement?

The southern enlargement[1] of the European Union during the 1980s has been used by many commentators as a benchmark for the assessment of the current wave of enlargement.[2] The reasons for doing so are apparent. For both the Southern and Eastern enlargements, the applicant countries were all going through the process of transition to democracy. In fact the time period between the end of the respective totalitarian regimes and induction into the Union are remarkably similar. In Spain, Greece and Portugal democracy emerged at the end of eras of dictatorship in the mid

[1] For reasons of clarity, 'southern enlargement' hitherto refers to the accession of Greece, Spain and Portugal to the European Union. The current wave of enlargement, although including Malta and Cyprus, will be referred to as the 'eastern enlargement'.
[2] Benton, P. (2002)

1970's. A decade later membership of the Union was achieved. In the Eastern candidate countries, membership was granted roughly a decade after the collapse of communism. The ten year period between the introduction of democracy and EU membership proved to be a testing time, both politically and economically, for both Southern and Eastern applicants.

Another interesting comparison that can be made between the two waves of enlargement involves the size of population and economic power. The population of Spain, Greece and Portugal in 1980 vis-à-vis the then other nine EU members and the population of the twelve applicant countries in 1998 (Romania and Bulgaria were not invited to join in 2002) vis-à-vis the current EU fifteen are relatively similar (28% for the latter, 22% for the former)[3]. As regards GDP, the size of the twelve applicant countries in 1998 in respect of the current EU fifteen was about 11% (PPS). Compare this with the figure from 1980 of 14% (PPS) for Spain, Greece and Portugal in relation to the then EU nine[4] and it is clear that, for the purposes of examination, both waves of enlargement had similar population size and national income significance.

A final important similarity regards the relative importance of agriculture in the economies of the applicant countries. Agriculture represents about 8% of GDP and 17% of total employment in the CEECs today. This is a very similar figure to that of Spain, Greece and Portugal in 1980. In 2000 however, the share of GDP of the agriculture sector for Spain was 3.7% while agriculture's share of total employment was 6.8%.[5] Figures for Greece and Portugal in 2000 were also significantly lower than in 1980. It is clear that since EU membership, the countries of the Southern enlargement have drastically reduced their dependence on agriculture, a sector which is inherently price unstable and exhibits low productivity. Through membership of the Union many of the CEECs will wish to follow the example of Spain, Greece and Portugal and reduce the share of agriculture in their national income figures.

Having examined many of the similarities between the two waves of enlargement it would be unwise to ignore the important differences between them, and to assess whether they are actually more different than they are alike.

The first notable difference between the southern and eastern experience is that of the transition to the market economy. Although Spain, Greece and Portugal emerged from periods of dictatorship into democracy, essentially the economic structural changes were minimal. In stark contrast the transition from fifty years of central planning in the ex-Soviet satellite countries represented a complete sea

---

[3] Roccas, M. and Padou-Schioppa, T. (2001)

[4] *ibid.*

[5] DG ECFIN Study, (2001)

change in the economic structure of the countries. During the 1990s the eastern European countries suffered many setbacks in trying to nurture the embryonic market system. Inflation and unemployment soared and deindustrialisation, due to receding demand, caused industrial output to plummet by an average of 20% per annum between 1990 and 1993.[6] In this sense the southern and eastern countries experienced incomparable fortunes in the decade before membership.

The second problem which arises when comparing the accession of the southern and eastern candidates is the difference between the respective levels of income per capita in relation to the EU average at the time of accession. In 1980 the average GDP per capita of Greece, Spain and Portugal was 66% of that of the then EU nine.[7] In contrast, the average GDP per capita of the twelve candidate countries vis-à-vis the EU fifteen was only 38% in 1998.[8] The invitation of membership offered to the ten successful applicants will therefore have the result of lowering the average income of the EU-25 significantly. This will make the challenge of income homogenisation across the Union a difficult and costly task.

A final difference between the two waves of enlargement concerns geographical location. With the enlargement eastwards, the locus of the EU is likely to shift to a more central European position, with Germany and Austria expected to be at the core of a new 'Mitteleuropa'. In contrast the southern enlargement did not switch the geographical core of the Union significantly to the south. This expected relocation may well have strong implications for future investment decisions as well as determining labour migration flows within an enlarged Union. This possibility has again raised the debate over the increasing gap between the core and periphery regions of the EU.

In summary, it is clear that many similarities exist between the southern and eastern waves of enlargement. It is also quite evident however, that the eastern enlargement poses some very significant obstacles, quite different from the southern enlargement experience. Although the southern enlargement offers some useful insights into what some aspects of the enlargement process are likely to bring about, it is not a sufficient benchmark by which to asses the likely implications of an EU comprising 25 countries and a combined population of some 500 million. In many areas, the EU is most definitely sailing into uncharted waters.

---

[6] McDonald, F & Dearden. S, (1998)
[7] DG ECFIN Study, (2001)
[8] Benton, P. (2002)

Economic Impacts: Can the European Union cope?

An enlarged EU is now a reality. The ten candidate countries will join the existing fifteen members by the summer of 2004. But what effects will such a monumental change to the make-up of the Union have? Will the Union be able to cope with such changes financially? To answer these questions we must examine more closely the impact of enlargement on the EU policy areas most likely to be affected.

The main, and most discussed, area of policy that is likely to be affected by enlargement is the EU budget. At present, the two main areas of EU expenditure are the Common Agricultural Policy and the Structural Fund, accounting for about 45% and 35% of the budget respectively.[9] The application of the CAP to future members was the final stumbling block in the pre-accession negotiations. Particularly vocal in this respect were Poland, the largest applicant and the biggest agricultural producer. At the Copenhagen Summit in December 2002, an agriculture package for the ten applicants was agreed: each candidate would receive a rural development package specifically tailored to their needs. Total expenditure on the new ten members was fixed at €5.1 billion for 2004-2006.[10] Direct aids for new members would be phased in over a ten-year time period, starting at 25% for 2004 and reaching 100% by 2013.[11] This will, it is hoped, help to ensure that maximum modernisation is achieved. The Copenhagen Agreement also established the ceiling on CAP market measures and direct aids for 2007-2013 at the level agreed at the Agenda 2000 meeting, but with the added increase of 1% per annum to allow for inflation[12]. As current CAP expenditure is approximately €2.6 billion below the Agenda 2000 ceiling, the cost of accession may not require the restructuring of the financing arrangements.[13]

As regards the Structural Fund, similar agreements were reached at the Brussels meeting in October 2002. Total expenditure on structural fund for the ten new members was established at €23 billion for the period 2004-2006. Each candidate would receive structural funding of 4% of GDP (agreed at the Berlin summit 1999). The arrangements for structural funding after 2006 are to be agreed sometime in 2004. The Second Cohesion report will establish the possible adjustment of the current structural funds eligibility threshold as its main objective.

---

[9] McDonald, F & Dearden. S, (1998)
[10] http://www.europa.eu.int
[11] *ibid.*
[12] *ibid.*
[13] Benton, P. (2002)

Overall, the costs of enlargement do not look like exceeding the ceiling set by the EU on the budget (agreed in Agenda 2000) of 1.27% of EU GDP. Given an EU GDP of about €8 trillion (EU-15) this represents a budget of about €100 billion. As the EU is only currently spending around €80bn there remains a surplus of some €20 billion that can be used to fund enlargement.[14] According to Gros,[15] a rough estimate of the costs of enlargement would be about €20 billion in transfers from the EU-15 to the new members. With an increased budget however the question will again arise regarding funding for the budget, with many countries likely to maintain that their contribution is disproportionately high. The enlargement of the Union therefore is not likely to be financially impossible, but it will put pressure on already weak budgetary funding arrangements.

Another important subject that must be addressed in view of the forthcoming enlargement of the Union is its effect on labour migration. Elementary microeconomic theory would profess that labour will relocate to wherever wages are highest. The net result would be a new wage level at which there would be no incentive to migrate. With wages in EU-15 five to ten times higher than the CEEC[16] average, are we to expect a flood of Polish workers to arrive on Irish shores willing to undercut our wage demands as the theory would suggest? This is unlikely. What microeconomic theory fails to recognise is that the vast majority of people are naturally migration-averse. It would be particularly surprising if large numbers of workers would wish to leave their own countries who have just become full members of the EU and were poised to reap the benefits of increased growth and productivity. Although workers from the applicant countries will have free access to the Irish labour market as soon as full membership is granted (Ireland is one of the few countries who will allow this), it is unlikely that we shall see many more migrants from the CEEC than we currently see from the EU-15. Although the net levels of labour migration for the European Union are expected to be low, it is most likely that labour outflows from new members will tend to be concentrated in a small number of regions, particularly in those regions that are closest geographically to the new members. The impact of this is that Germany and Austria, who share long stretches of border with Poland and the Czech Republic for example, may well suffer labour market adjustment problems, particularly in border regions. In the long run however, the advantages of labour migration east to west are expected to outweigh the disadvantages, as inflows of labour may go some way to easing the potentially enfeebling effects of the forecasted high dependency ratios of the EU-15

[14] DG ECFIN Study, (2001)
[15] Gros, D. (2001)
[16] DG ECFIN Study, (2001)

A final area worthy of examination is the likely impact of enlargement on trade and investment within the Union. Trade, and in particular intra-EU trade, is not expected to be effected greatly by enlargement. Through the various Europe agreements signed during the early and mid-1990s, formal trade barriers in the EU to imports of industrial products have now been completely dismantled. A similar situation exists in the CEECs (a notable exception to this is agricultural produce where abolition is reserved until full membership). What continues to hamper the prospect of an enlarged single market however, are those problems by which the existing single market is already plagued, namely informal barriers to trade. Although many attempts are being made with increasing regularity to break down these barriers, particularly surrounding technical standards and the principle of mutual recognition, obstacles still remain in achieving an efficient single market. This is the case now for the EU-15 and, unless serious inroads are made into the resolution of the issue, it will remain the case when the eastern applicant countries gain full membership in 2004. The impact on the movement of capital into and within the EU is likely to be more pronounced. Over the last twenty years probably the biggest change in the world economic make up is the dramatic increase in the mobility of capital. The effect of this increased mobility is that the CEECs are likely to see large increases of inflows of foreign direct investment arising from full membership of the EU This capital is likely to originate in countries that currently enjoy strong economic ties to the eastern applicants, in particular Germany and Austria. Much discussion has arisen, especially in Ireland and other FDI dependent countries, regarding the potential for capital relocation towards the new eastern members and the detrimental effect such changes are likely to have on their economies. We must remember however, that although the eastern countries are likely to become more attractive to FDI when in receipt of full membership, the capital absorption capabilities of most of these countries is relatively low in comparison with the current EU FDI dependent countries. For this reason, it is accurate to say that EU membership for the CEECs is likely to greatly increase their attractiveness to FDI, but generally will not have a disastrous effect on the economies of current FDI dependent countries within the EU

Conclusion

So where do we stand? We have seen that analysis of previous enlargement is not sufficient to determine the full impact of the eastern enlargement. Although the similarities between the two waves allow us to make some general inferences, the differences between them are too great to allow for the prediction of specific economic outcomes. We have also looked at what is likely to happen to trade and investment in the Union, possible labour migratory effects and also the likely impact on the budget of the EU Stemming from this analysis, the most problematic and most discussed question has been answered. Enlargement can be afforded in the short term. However this is all we can be sure of. The future will bring about many unpredictable challenges for Europe. We now prepare to sail towards these challenges with neither map nor compass.

References

BRENTON, P., (October 2002), *The Economic Impact of Enlargement on the European Economy: Problems and Perspectives*, CEPS Working Document No. 188.

BURDA, M., (1998). (May 2001), *The Consequences of EU Enlargement for Central and Eastern European Labour Markets*, London Centre for Economic Policy Research, *The Economic Impact of Enlargement*, A study by DG ECFIN.

GABRISCH, H & POHL R., (1999). *European Union Enlargement and its Macroeconomic Effects in Eastern Europe: Currencies, Prices, Investment and Competitiveness*, , Basingstoke: Macmillan,

GROS, D., *A Primer on the Cost of Enlargement*, , CEPS Commentary, 2001.

KATELI, LAIKA T., (2001) ‘The Internationalisation of Southern European Economics’ from *Economic Transformation, Democratization and Integration into the European Union: Southern Europe in Comparative Perspective,* Houndmills: Palgrave,.

MCDONALD, F. & DEARDEN. S., (1998). *European Economic Integration*, 3rd Edition, Longman

ROCCAS, M. AND PADOU-SCHIOPPA, T., (2001) ‘Economic Change and the Process of Democratisation in Southern Europe’, in *Economic Transformation, Democratization and Integration into the European Union: Southern Europe in Comparative Perspective*, Houndmills: Palgrave,

SALZMANN, M., (May 2002.) *Eastern European Workers to Pay the Cost of Membership in European Union,* ICFI,

Online References

http://www.europa.eu.int
http://www.europa.sk
http://www.eu2002.dk
http://www.europa.ie