Widening of the EU: Eastern Enlargement

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New EU Member States

- 1st May 2004: 10 new Entrants (EU25)
  - Central Europe: Poland, Czech Republic, Slovakia, Slovenia, Hungaria
  - Baltic States: Estonia, Lithuania, Latvia
  - Mediterranean States: Malta, Cyprus
- Prospective Member States
  - Bulgaria and Romania (2007)
  - Croatia
  - Turkey (?)
  - Ukraine (?)
  - …

Why Enlargement?

- **History/culture:** the division of the second half of the last century has been an artificial caesura in what has been a shared path of evolution for centuries

- **Politics/security:** given the prosperity of the EU, to deny membership would have posed a serious problem of security at the EU borders, let alone this being contrary to the spirit of the EU Treaty

- **Economics:** Market integration clearly anticipated the political process

Short chronology of Eastern Enlargement

- Berlin Wall falls : 11/89
- German unification: 10/90
- “Europe Agreements” coming into force 4/94: with PL, HU (12/91), CZ & SK (10/93), BU & RO (3/93), EE, LV, LT (6/95), SI (6/96)
- Copenhagen European Council I sets criteria for EU membership for CEECs: 6/1993
- Luxemburg European Council calls for opening of bilateral negotiations with first & second wave of countries 12/97
- Helsinki European Council formal accession process with all 12 countries (incl MT, CY), TR candidate country status
- Copenhagen European Council II officially closes accession negations with 8CEECS& MT&CY; financial package agreed (12/02)
- Accession Treaties signed in Athens (4/03)
- 10 NMS join the EU : May 2004

The Accession Strategy

Pre-accession strategy important for success

- **Definition of a clear legal framework:** ***Europe Agreements***
- **Definition of clear criteria for membership:** ***Copenhagen criteria***
- ***Aid*** **for implementation of criteria**

Europe Agreements
(in force from April 1994 till May 2004)

- **EU removes quantitative restrictions for all industrial products**
- **EU tariffs removed immediately for most goods**
- **Gradual tariff reductions and quota increases for EU sensitive goods (within 5 years)**
- **Reciprocal commitments were spread over long period**

Exceptions: agricultural goods, many textiles, coal, steel

Copenhagen criteria

- **Political**: stable institutions guaranteeing democracy, rule of law, human rights and respect for minorities
- **Economic**: ability to withstand competitive pressure inside the EU (ie having a functioning market economy
- **Legal and institutional**: ability to take all obligations of EU membership (ie Community acquis): adherence to the various political, economic & monetary aims of the EU

Note

- **Bilateral National Programmes** for the adoption of the Acquis: setting of clear priorities for each country and identify main instruments anf finances to close the chapters of the accession negotiations
- EU’s capacity to absorb new members also taken into account

Pre-Accession Assistance

- **Phare**
  - Finances institution building measures across all sectors and investments in fields not covered by other two instruments; incl integrated regional development
- **ISPA**
  - Finances major environmental and transport instrastructure projects
- **SAPARD**
  - Finances agricultural and rural development

Impact of Eastern EU Enlargement

- **2004-Enlargement**
  - EU population + 25 % (> 500 million)
  - EU Territory + 30 %

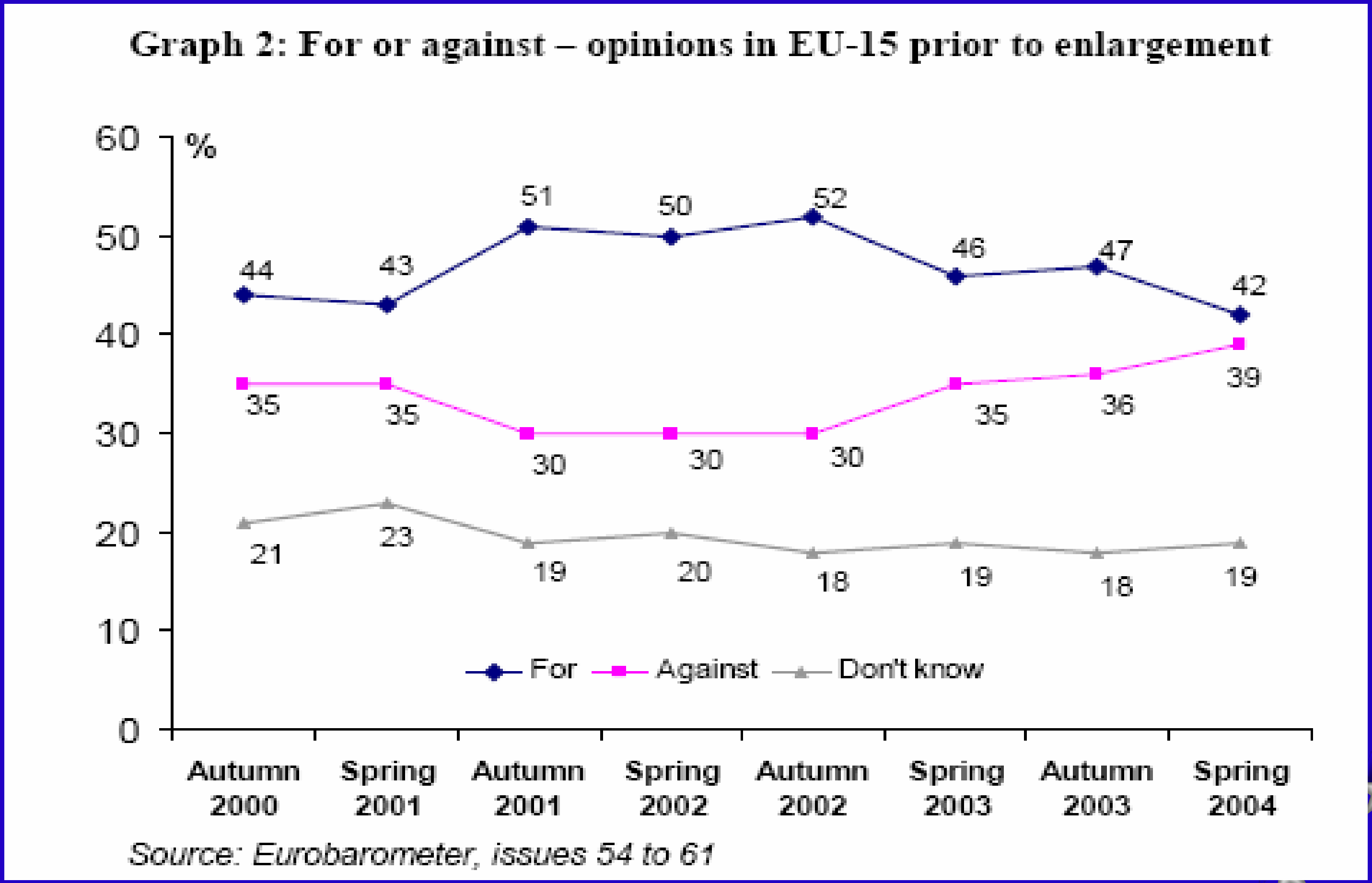
    BUT:
    - EU total GDP + 5 %
    - Heterogeneity among Candidate Member States
- **2007 and further:**
  - poor countries: agriculture dominant
  - Size of some countries (Turkey, Ukraine)

=> Concerns about Enlargement

Public support for enlargement

Enlargement: for or against?

Opinions in the EU-15 before 2004



Enlargement: for or against?

Opinions in NMS

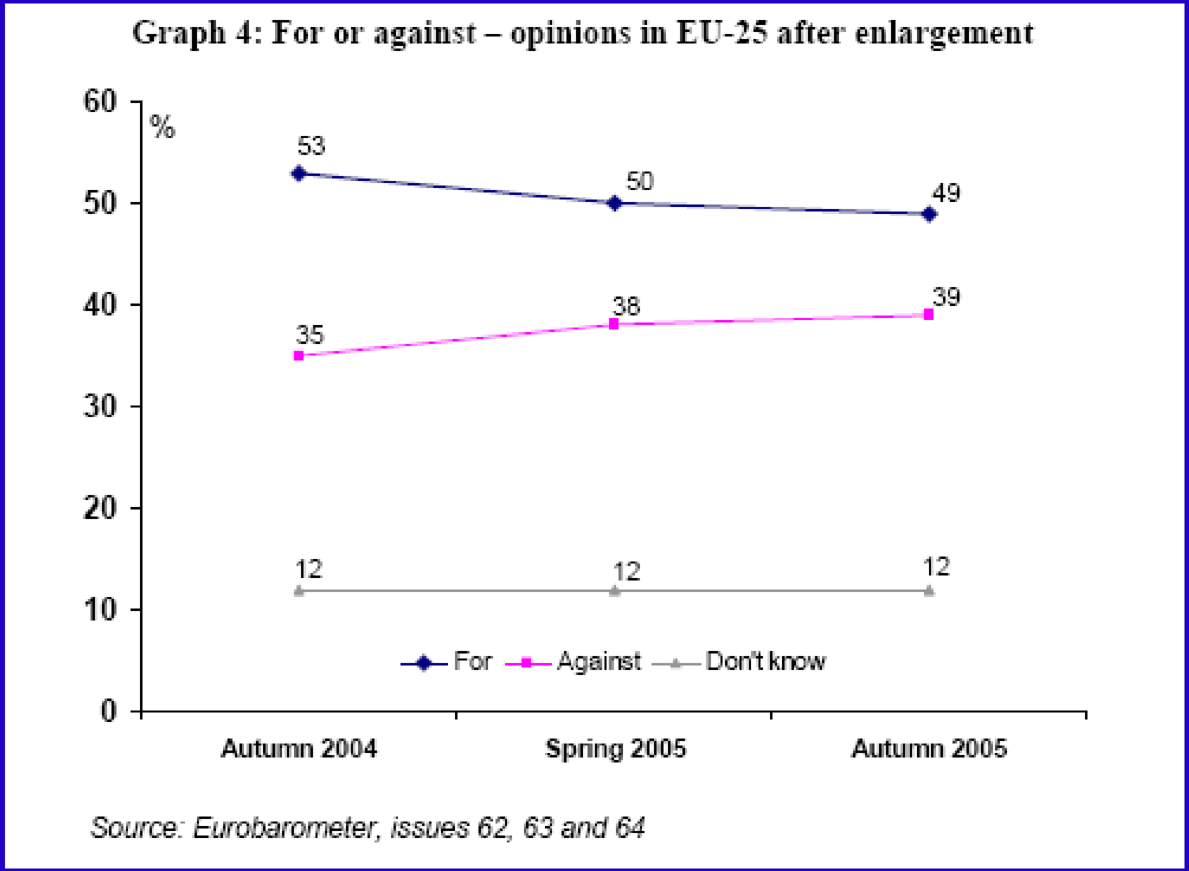
Table 1: Results in referenda on EU accession

Country	Turnout %	Yes %	No %	Support[1] %	Date	Recent turnout[3]
Cyprus[2]	na	58	25	na	Autumn 2002	na
Malta	91.0	54	46	49.1	March 8, 2003	97.0 (2003)
Slovenia	60.3	90	10	54.3	March 23, 2003	70.1 (2000)
Hungary	45.6	84	16	38.3	April 12, 2003	70.5 (2002)
Lithuania	63.3	91	9	57.6	May 10-11, 2003	58.2 (2000)
Slovakia	52.2	93	7	48.5	May 17, 2003	70.0 (2002)
Poland	58.9	77	23	45.4	June 7-8, 2003	46.3 (2001)
Czech Republic	55.2	77	23	42.5	June 13-14, 2003	58.0 (2002)
Estonia	63.0	67	33	42.1	September 14, 2003	58.2 (2003)
Latvia	72.5	67	32	48.6	September 20, 2003	71.5 (2002)

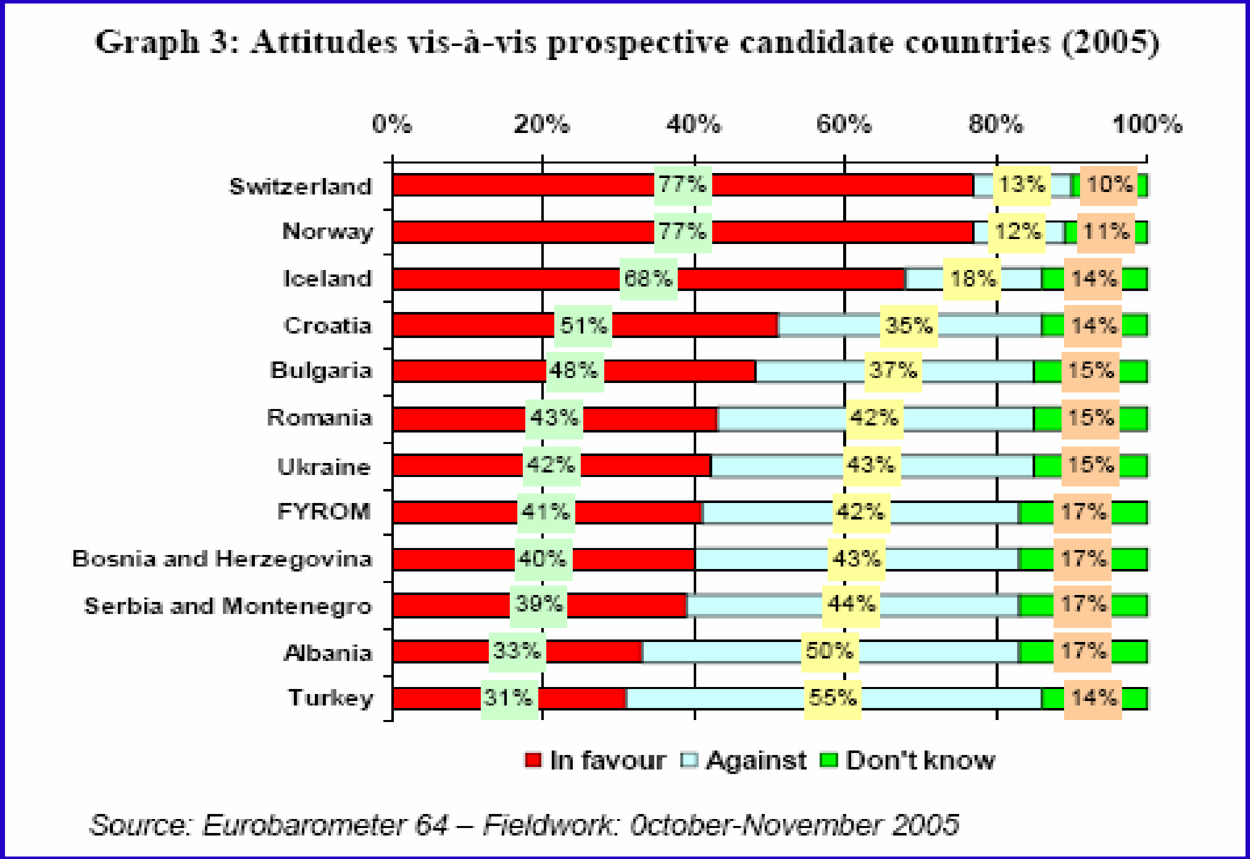
na = not available; 1 percentage of eligible votes who supported accession; 2 Cyprus approved the Accession Treaty in the legislature and the results of the latest opinion poll are reported; 3 participation in the parliamentary elections (year in parenthesis) adjacent to the time of the referendum.

Source: Doyle and Fidrmuc (2004), Table 2.

Enlargement fatigue: *opinions in EU-25 after enlargement*



Enlargement fatigue: *Attitude towards prospective candidate countries (2005)*



Public support for Enlargement

- Mixed support for enlargement in EU-15 and the NMS
- Enlargement fatigue

Since support depends on conceived costs/benefits, we need analysis of the actual costs/benefits of enlargement to inform the public better

Analysis of economic impact of enlargment

Ex ante expected effects

The New EU: Challenges and Opportunities for EU-15

Opportunities

- Larger Market (Scale)
- Political importance
- Historic Opportunity

A step-back in the European Integration Process?

= *widening instead of deepening*

Challenges

- Border Concerns, Migration and Delocalisation
- Integration "benefits" already fulfilled?
- Fair treatment of New Member States
- Political decision making process
- Reforms in CAP and Structural Funds
- Risk of Asymmetric shocks
- *Creating Competitiveness*

The New EU: Challenges and Opportunities for New Member States

Opportunities

- Larger market
- Financial Aid
- Access to technology/ knowledge, capital…
- Economic Growth (and convergence)
- Historic Opportunity

Challenges

- Reforms in Agriculture, Manufacturing
- Political Stability
- Acquis Communautaire
- Building Modern Welfare States
- EMU and euro

Estimates of the economic impact of enlargement

- **Enlargement was expected to be beneficial overall, with a much stronger effect on the new Member States for reasons of sheer relative size and development level.**
- **Intensifying commercial links, foreign direct investment, lower risk premia, greater efficiency through adopting market mechanisms, macroeconomic stability were thought to be behind the good results.**
- **Negative consequences such as outsourcing, uncontrollable migration flows, downward pressure on wages in the old Member States and huge adjustment costs in the new Member weighing public finances would be contained and transitory on average, although prevailing for specific sectors, regions, skills**
  - DG ECFIN (2001) estimated additional growth of 1.3/2.1 % per year for the new Member States in 1994-2009, while in the old Member States growth would be a cumulative 0.5/0.7 % higher.
  - Similar orders of magnitude are given by Baldwin et al. (1997) who saw steady state real income 0.2 % higher in the old and 1.5/18.8 % in the new Member States.

An ex post assessment of Enlargement

The optimists proven right

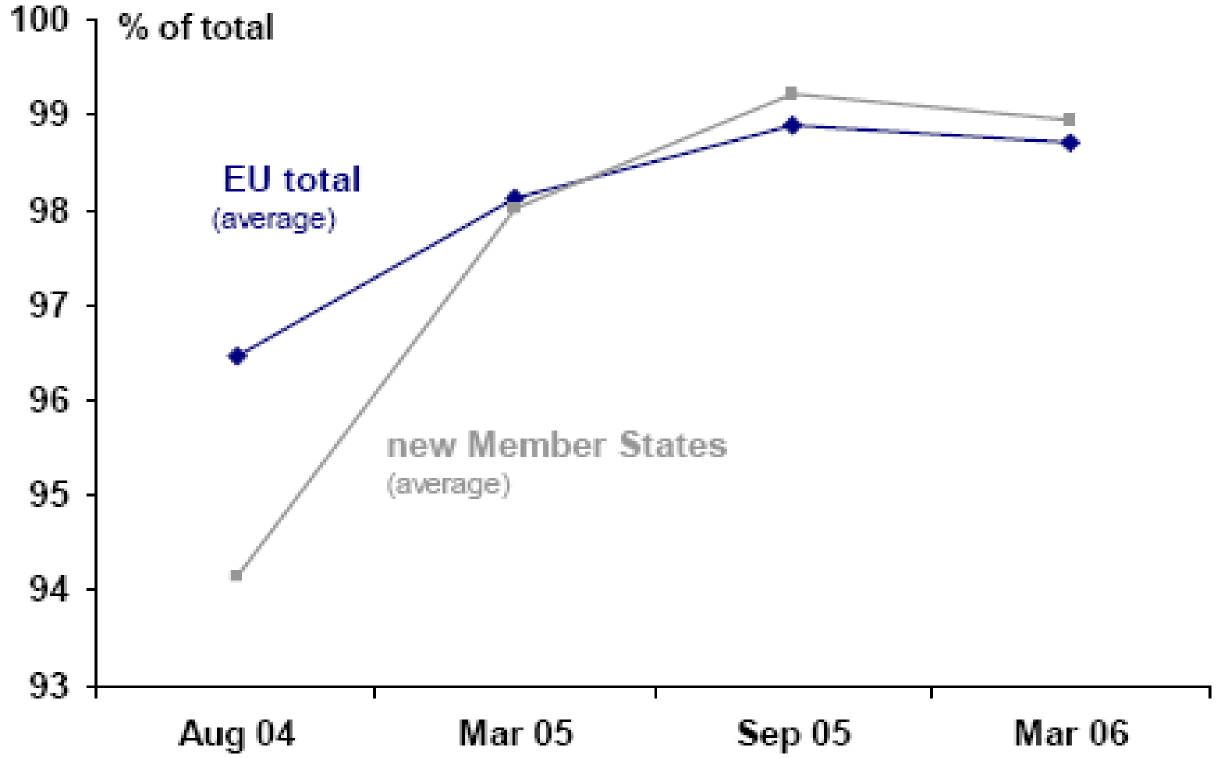
I. Assessing the enlargement process itself

1. NMS coping with the acquis
2. EU Budgetary resources to the NMS
3. Economic Reforms in the NMS

1. NMS coping with the acquis

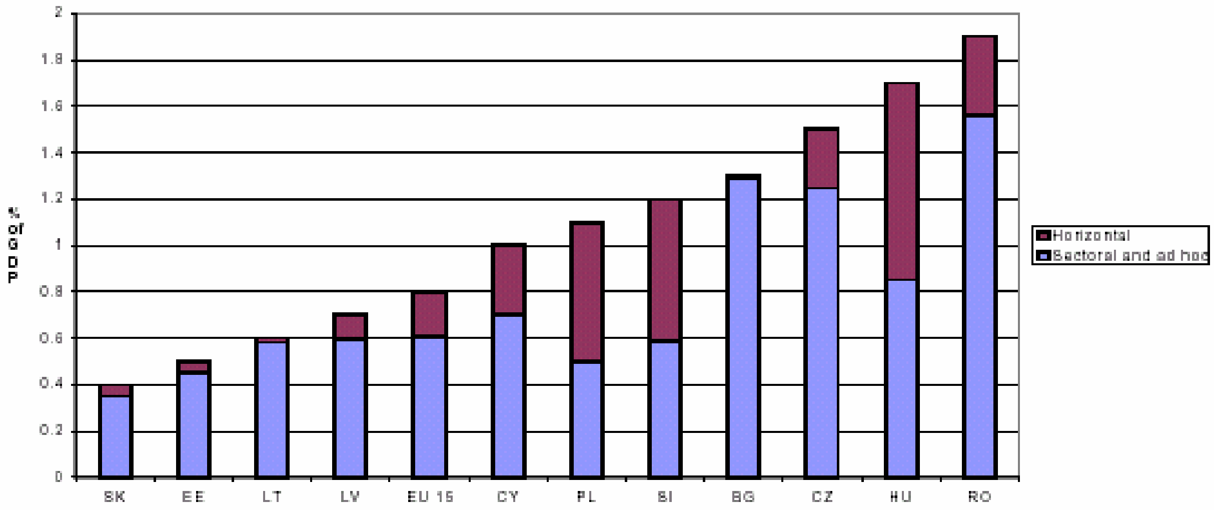
- With a transposition of 99 % of directives into national legislation in March 2006 (compared to 90 % in August 2004), new Member States have made rapid progress in implementing the EU acquis.
- Only in the area of competition, new Member States show a certain lag of transposition vis-à-vis the average of all Member States.

Graph 5: Notification of national measures implementing EC directives



Source: Commission services

Graph 7: State aid in 2000 (% of GDP)

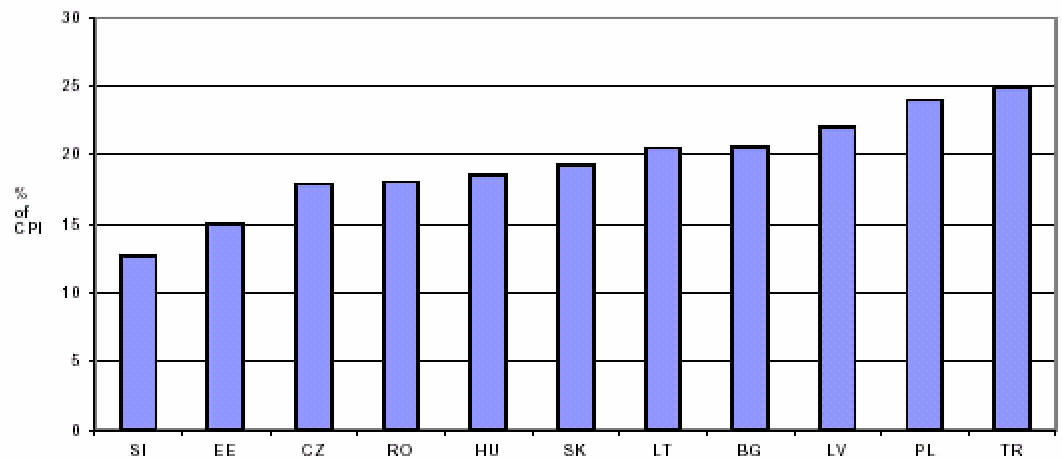


Source: State Aid Scoreboard special edition.
Note: Figures exclude aid to fisheries and agriculture. Data r

- New member States have to further reduce the level of **State aids**, still above the EU average...

…as well as the pervasiveness of **administered prices**

Graph 6: Administered prices in 2001 as a share of CPI



Source: *Commission regular reports.*
Note: *Data for PL, SI and SK from 2000. No data for CY and MT.*

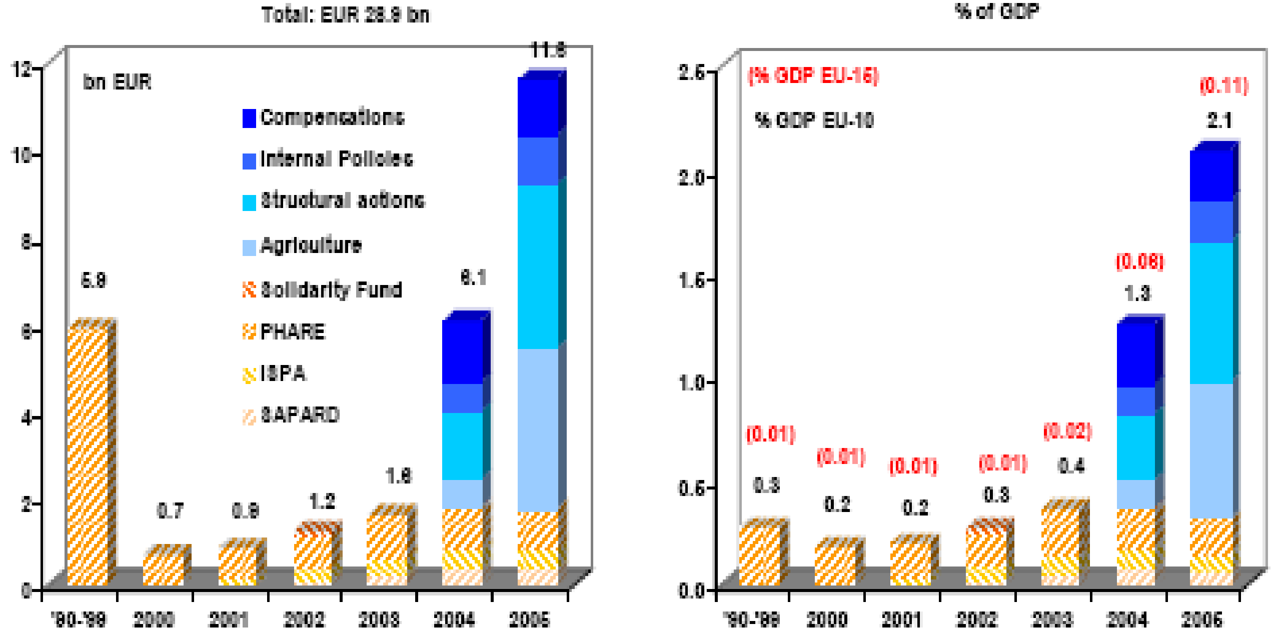
NMS coping with the acquis

- **Benefit:** The transposition effort has allowed the NMS to adopt modern regulatory frameworks in areas such as financial markets, company law, accounting, IPR, which has created a better environment for business and growth, as such completing the process of transition
- **Cost:** The cost of compliance with the acquis is difficult to estimate, but can be considerable, notably in environment and transport. It should be noted that these costs are to be spread out over an extended period of time and to be significantly co-financed by EU assistance.

2. EU budgetary resources to the NMS

- **From accession, the regular EU finance mechanism is in place with the 3 recurrent budget headings (agriculture, structural actions and internal policies) and "compensations".**
- **In total about EUR 28 billion has been transferred to the 10 new Member States in the last 15 years. The annual amount increased over time and reached about EUR 12 billion in 2005, representing 2.1 % of EU-10 GDP.**
- **The amounts disbursed to the new Member States represent 6.9% of the EU budget. This is only 0.1 % of GDP in the old Member States.**
- **Because of additionality requirements (in certain domains EU money may not replace national expenditure) and co-financing requirements (in order to foster financial responsibility), there was the fear that national budgets in the new Member States would deteriorate. This does not appear to be the case. For the group as a whole, a favourable effect on national budgets of 0.3 % of GDP is estimated in 2004, going to more than 1 % of GDP in the Baltic States.**
- **With respect to the future, net transfers to the new Member States will increase from an average of 1% of GDP in 2004-2006 to 2.8% for the period 2007-2013 under the proposed new financial framework. This significant rise in EU assistance remains small from the perspective of the old Member States.**

Graph 7: EU payments to recently acceded countries



Source: Commission services (2005: estimates)

3. Economic Reforms in the NMS:

Beyond the acquis strictu sensu, all NMS, like the old Member States, are, in the framework of the Lisbon Strategy in the process of completing reforms, as specified in their National Reform Programs, particularly to tackle key challenges in infrastructure, ICT, skills development, R&D and innovation, business environment & entrepreneurship while at the same time sustaining public financing.

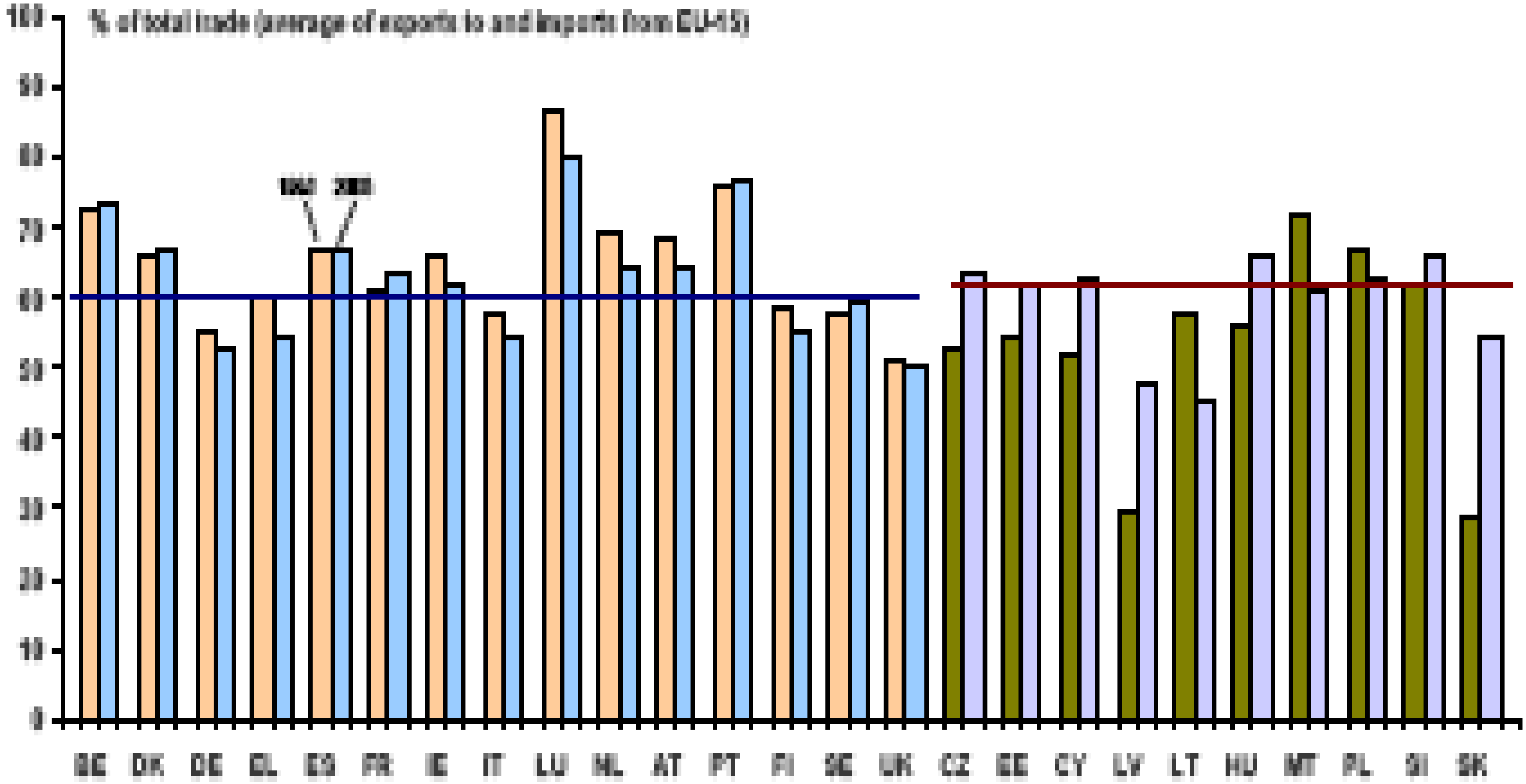
II. The level of integration in the enlarged EU

1. Trade Flows
2. FDI Flows
3. Labour/Migration

1. Rapid Trade Integration

- **Trade liberalisation through the Europe agreements signed with the candidate countries in the early nineties and the prospect of EU accession, led to a marked trade integration, mainly before joining the EU when exports and imports were surging.**
  - There are large country differences with Cyprus, the Baltic states and Slovakia having less intense trade relations with the old Member States.
- **Over the period 1993-2005, the EU-10 increased its market share in the EU-15 (excluding intra-EU-15 trade) to about 13 %,**
  - the Czech Republic and Poland being the largest exporter.
- **About 70 % of extra EU-10 imports of goods in 2005 come from the old Member States. However, faced with increased competition, mainly from the recently acceded countries, the old Member States have been losing some ground since accession.**
  - Germany being the top exporter.
- **The trade creation inside the EU as a consequence of enlargement did not lead to trade diversion as also trade with the rest of world intensified.**

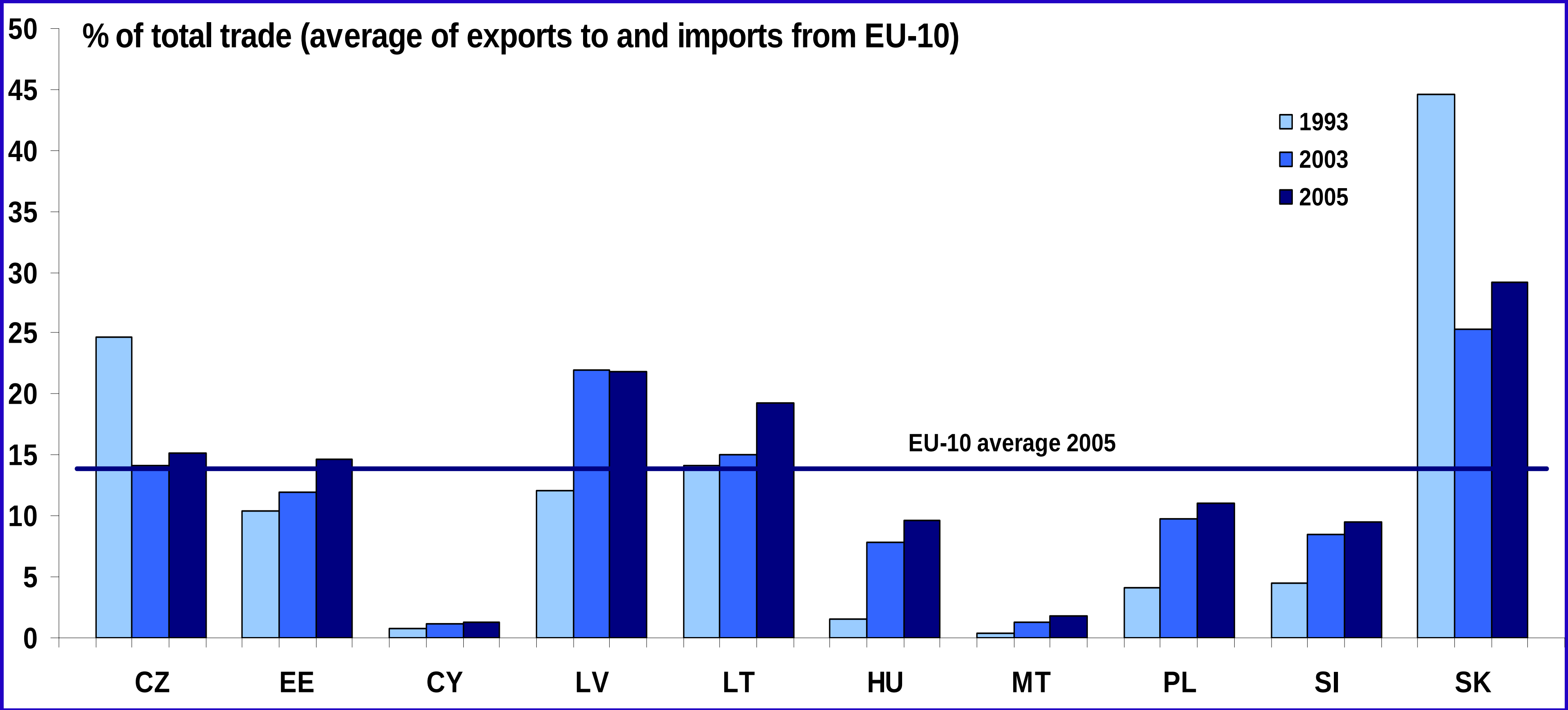
Graph 24: Trade integration with EU-15, 1993 and 2005



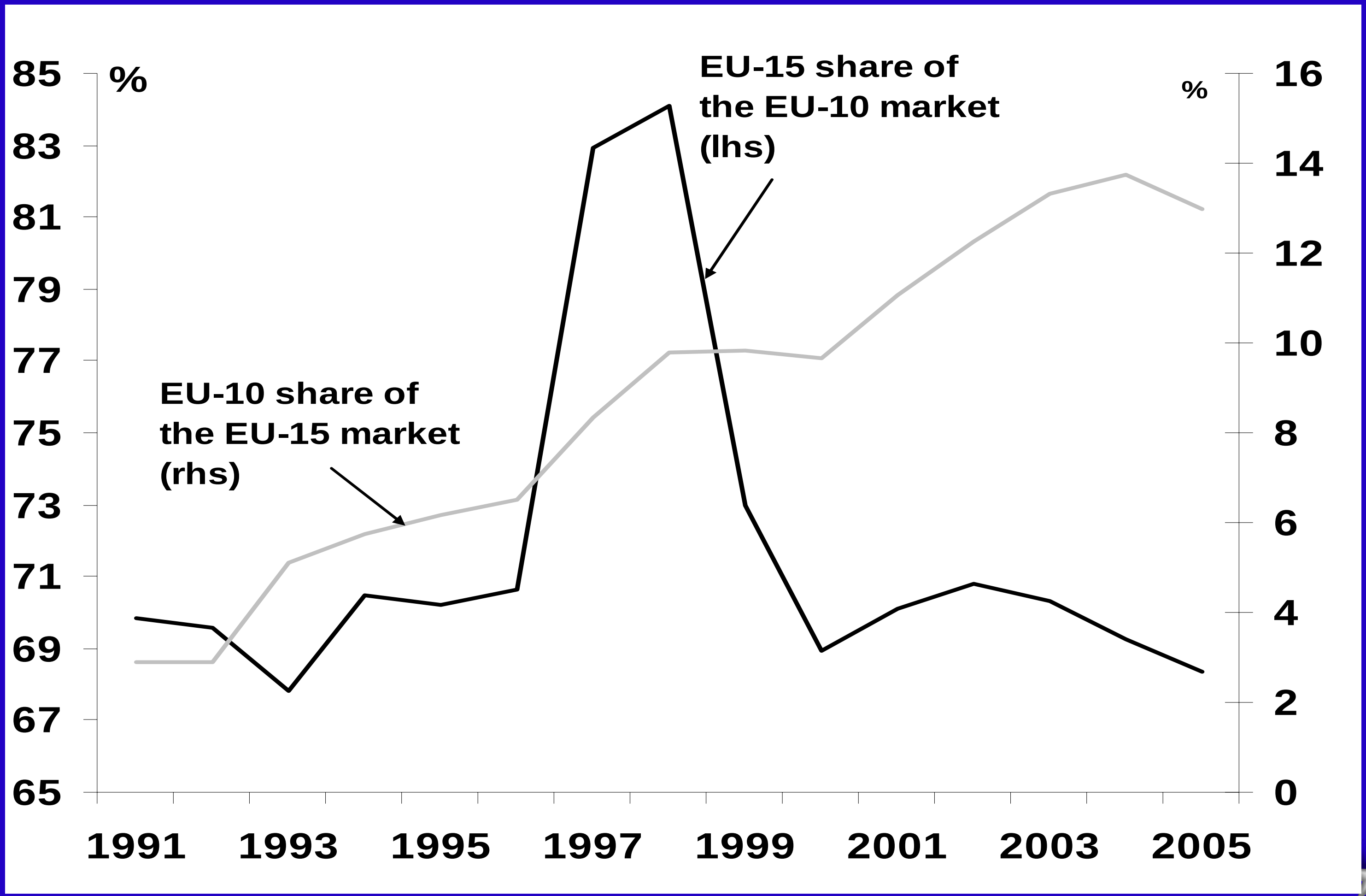
Note: For 2005, estimates based on data up to June 2005.

Source: Commission services calculations based on IMF Direction of Trade Statistics

Intra-EU10 trade



EU10&EU15 export market shares

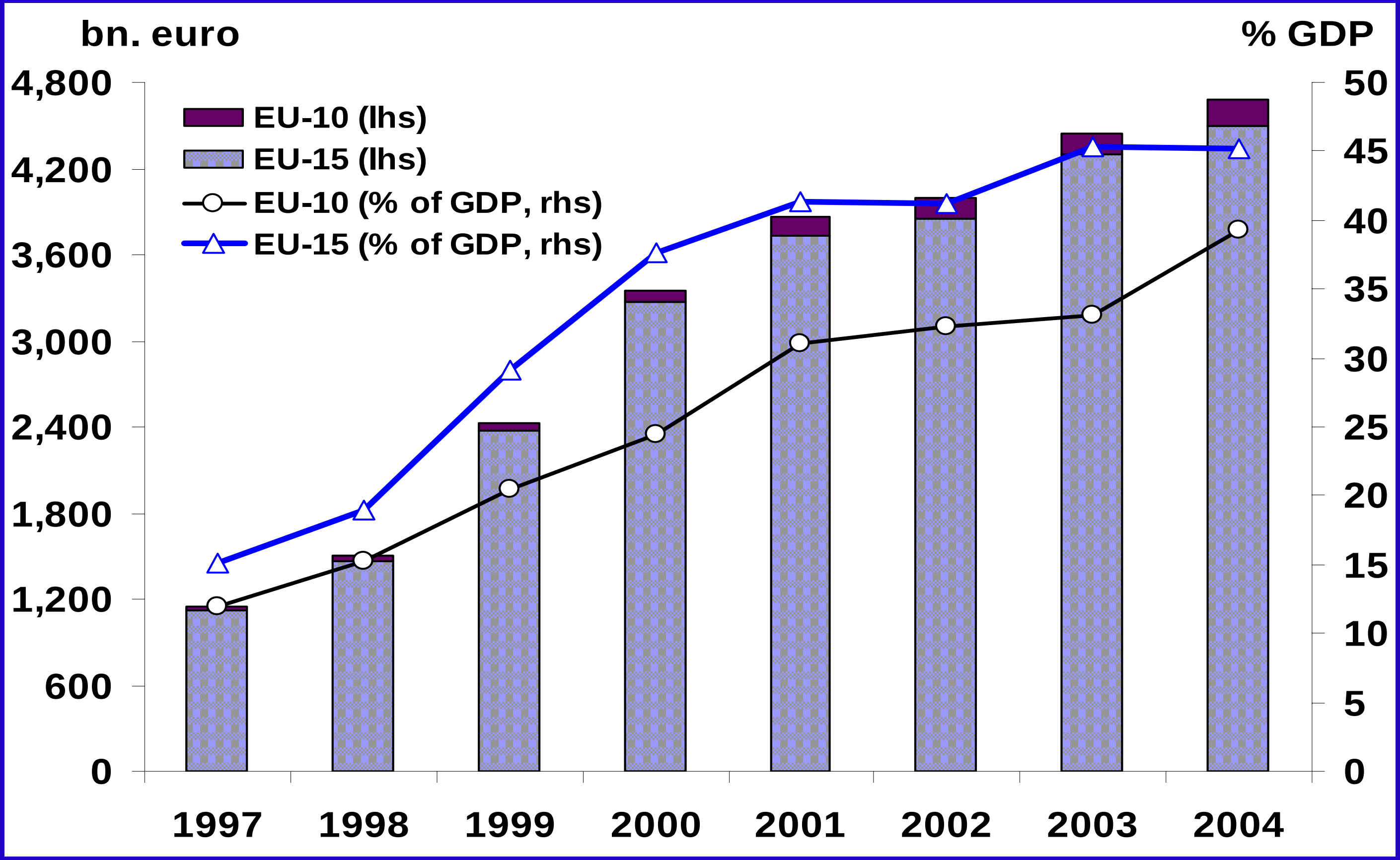


2. Increased Foreign Direct Investment

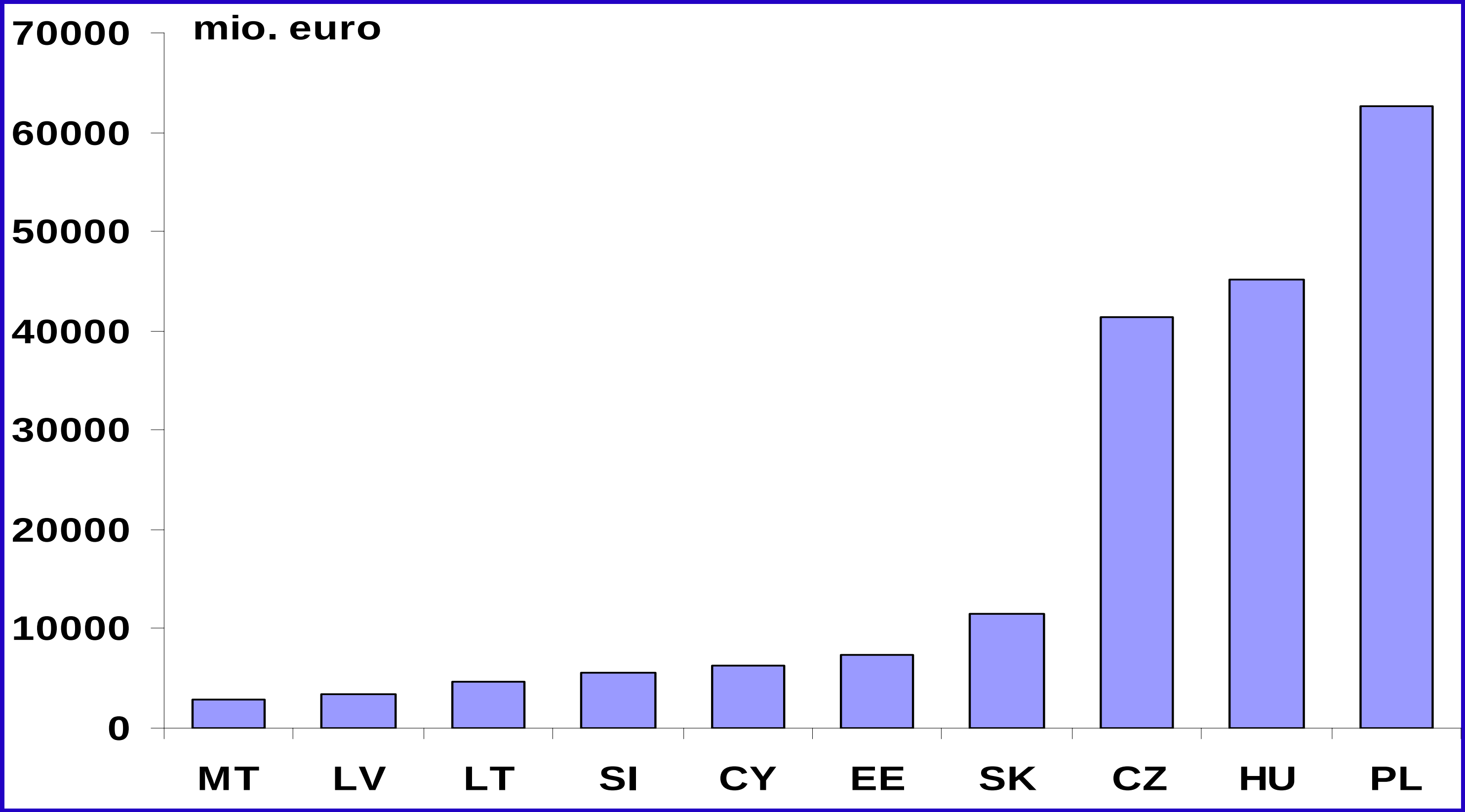
Since the mid-nineties the presence of foreign firms in the new Member States has grown systematically, representing 40 % of local GDP in 2004, from virtually nothing ten years earlier.

- **With a share of three quarters, the old Member States are the main investor in the NMS.**
- **The larger part (55 %) is invested in services, following by manufacturing (37 %).**
- **Germany is the top investor and particularly active in the neighbouring Czech Republic, Hungary, Poland and Slovakia.**
- **Scandinavian countries are the main investors in the three Baltic States.**
- **While in the Baltic States and to a lesser extent in Poland foreign direct investment is still concentrated in traditional industries like food processing, textiles and wood products, in Hungary and the Czech Republic foreign investors focus on modern manufacturing sectors (office machinery, computers, telecommunication, cars).**

Evolution of inward FDI stocks in EU15 & NMS



Inward stocks in NMS 2004



Stocks of FDI in NMS by sector, 2003

Manufacturing sectors in 2003									
(in percent of total)	Food products	Textiles & wearing apparel	Wood, publishing & printing	Petroleum, chemicals, rubber & plastic products	Metal & mechanical products	Office machinery, computers, radio, TV and communicatio n equipment	Medical, precision and optical instruments, watches and clocks	Vehicles & other transport equipmen t	Other
CZ	11.1	2.3	7..3	13.5	16.4	5.6	1.8	22.7	17.8
EE	21.3	7.9	19.2	9.4	8	3.4	0.5	8.2	
HU	13	1.8	4.5	20	11.7	12.1	0.8	24.7	2.2
LT	37.6	9.5	8.2	21.1	3.2	4.2		5.7	
LV	27.7	11.2	27.7	11	8.7	0.2	0.2	0.2	12.9
PL	18.9	1.4	11.3	17.9	9.9	4		16.7	
SK	18.6	2.1	4.5	23.7	28.9	2.5		-1.2	
Total	15.5	2.2	8	17.4	13	6.7		19.4	

3. Limited migration so far

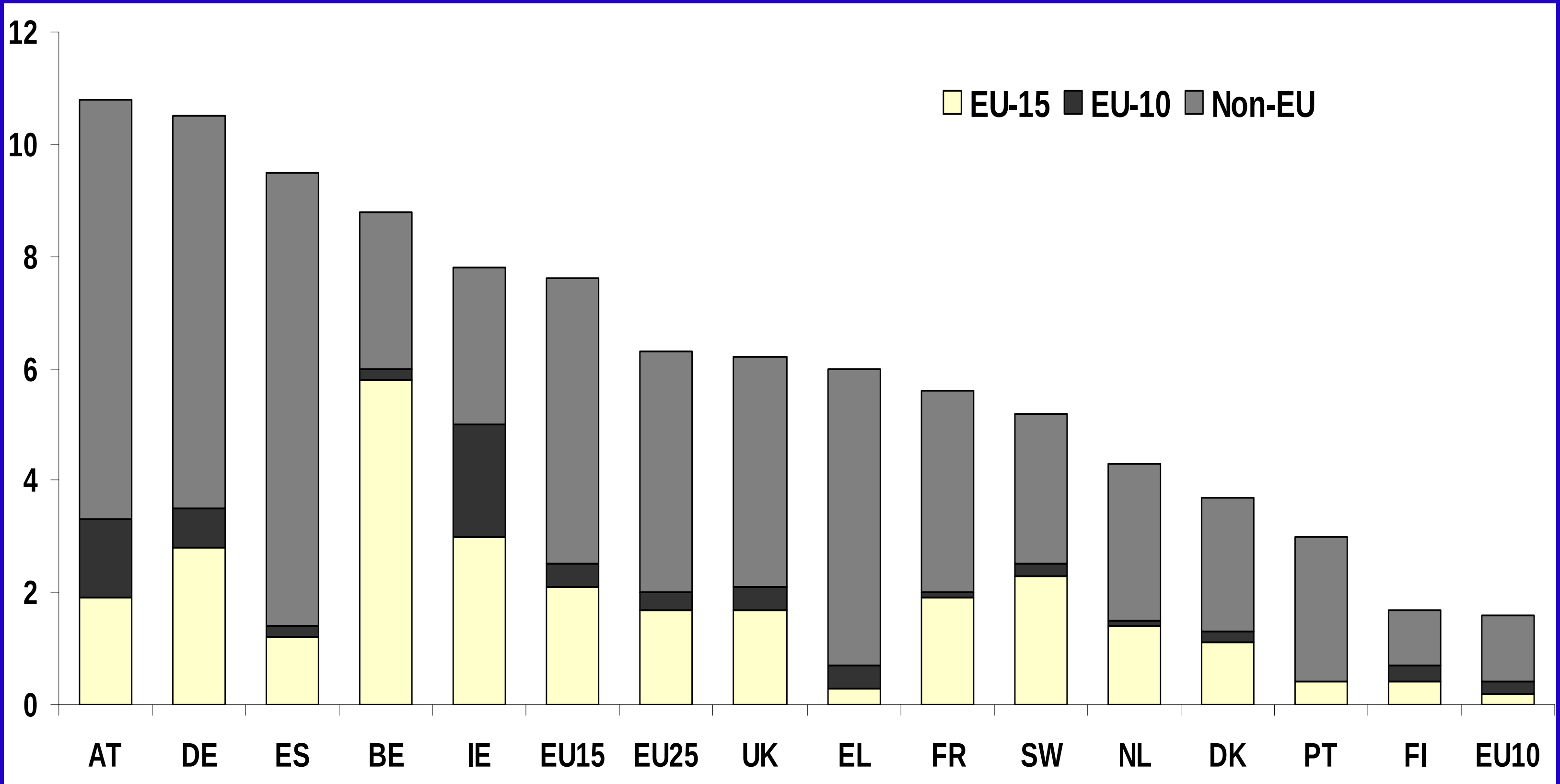
- **Given that barriers to trade, foreign direct investment and other capital movements had already been removed prior to enlargement, the free movement of persons and workers constituted the most significant dimension of economic integration on 1 May 2004.**
- **However, the free circulation of labour is sensitive because of the fear of unfair job and wage competition as well as the associated illegal immigration.**
- **Therefore the Accession Treaty of 2003 allowed during a nine year transition period a derogation from the principle of the free movement of persons.**
  - Only Ireland, Sweden and the United Kingdom, decided not to make use of the possibility to impose restrictions, while the other old Member States maintained a work permit regime, sometimes combined with a quota system.
  - All new Member States opened their labour markets to each other, but Poland, Slovenia and Hungary apply reciprocal restrictions to EU-15 nationals.

3. Limited migration so far

Studies before accession on potential migratory flows and the experience so far, indicate a limited impact on the labour market.

- **The migration potential for the EU is estimated at 2-4 % of the source population in the new Member States.**
- **Cumulated over 15 years, this amounts to 1.2 % of the projected EU-15 working age population in 2020. In the first year of accession, migration could be larger and decline afterwards. Recent information confirms these expectations.**
- **Migration from third countries is more important than intra EU mobility.**
- **In 2005, the highest shares of non-nationals in the working age population (about 10 %) are observed in Austria and Germany, of which 1.5 % and 0.6 %, respectively, come from EU-10. The largest EU-10 representation of about 2 % is found in Ireland.**

Share of foreign nationals in resident working age population, 2005



III. The Economic Performance of NMS & EU-15 after Enlargement

1. Strong growth & catching up
2. Public finance & stability
3. Improving trade performance on world markets
4. Labour markets in transition, but since accession the situation is improving
5. Fears of outsourcing are exaggerated

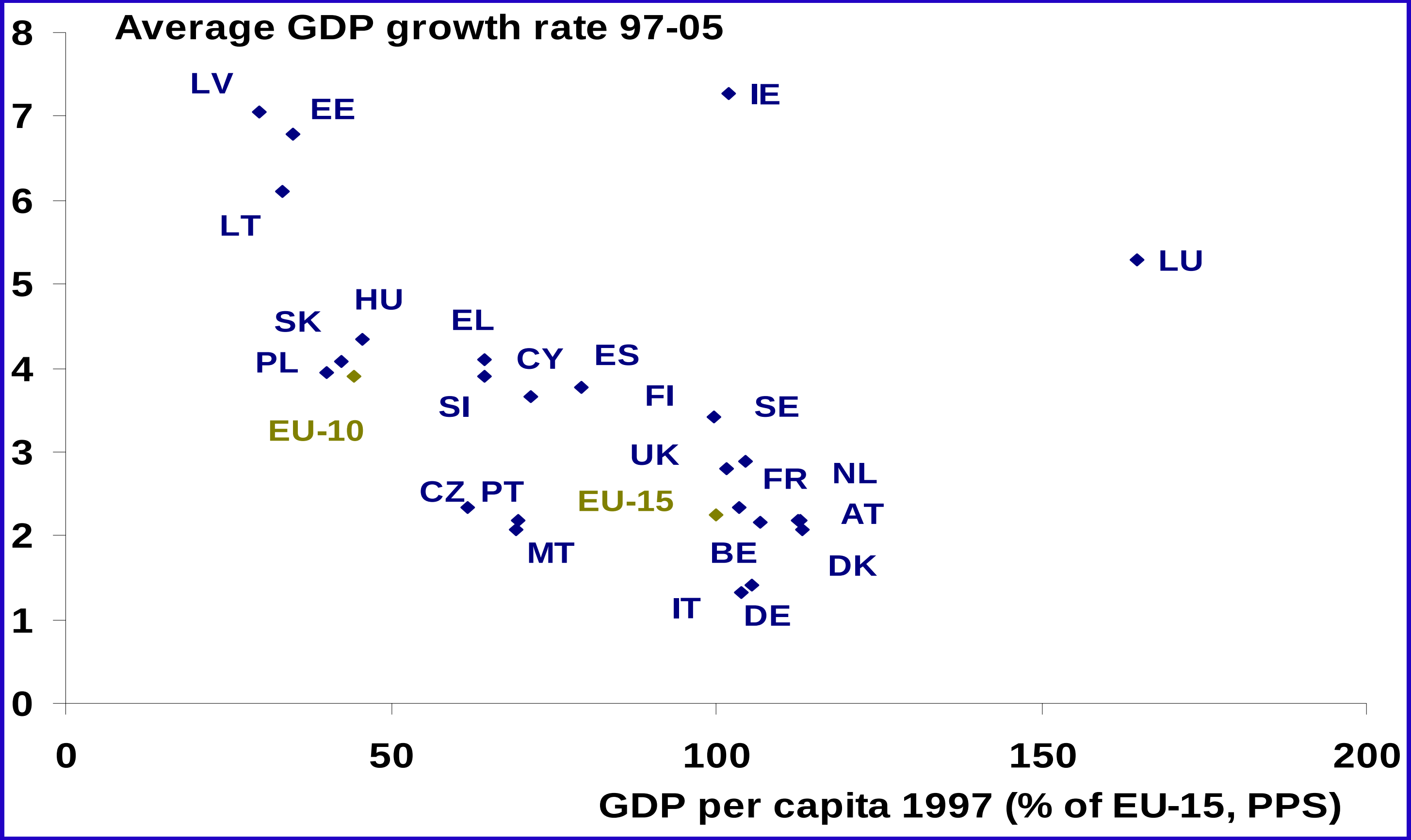
1. Strong growth & catching up

- **Starting from low income levels, growth was on average faster in the recently acceded Member States compared to the old (3¾ % per year versus 2½ % in 1997-2004).**
- **It permitted to narrow the income gap from 44% of the EU-15 level in 1997 to roughly half of this level in 2004.**
  - Particularly impressive catching-up took place in the Baltic countries but also in Hungary and Slovenia, in spite of the fact that the latter country had a comparatively high per-capita income already in 1997.
  - In general, countries with the lowest initial per-capita incomes tended to grow fastest.

Growth and real convergence

Countries	GDP Per Capita (% of EU-15, PPS) 1997	GDP Per Capita (% of EU-15, PPS) 2005	Average of real GDP growth (in %) 1997-2005	Volatility of real GDP growth(2) 1997-2005
CZ	61.9	67.8	2.3	2.2
EE	35.0	51.7	6.8	2.9
CY	71.5	77.5	3.7	1.2
LV	29.8	43.1	7.1	2.0
LT	33.3	47.1	6.1	3.2
HU	45.5	57.2	4.3	0.5
MT	69.3	64.3	2.1	2.8
PL	40.1	46.0	3.9	1.8
SI	64.5	75.0	3.9	0.9
SK	42.3	50.1	4.1	1.4
EU-10(1)	44.3	52.1	3.9	1.9
BE	106.7	109.1	2.2	1.0
DK	113.3	114.6	2.1	1.1
DE	105.6	100.0	1.4	1.0
EL	64.3	77.1	4.1	0.6
ES	79.3	90.7	3.8	0.8
FR	103.6	100.5	2.3	1.1
IE	101.9	127.7	7.3	2.7
IT	104.0	95.8	1.3	1.1
LU	164.6	214.0	5.3	2.6
NL	112.5	114.2	2.2	1.6
AT	112.9	113.3	2.2	1.0
PT	69.5	65.8	2.2	2.0
FI	99.5	104.2	3.4	1.6
SE	104.6	109.5	2.9	1.2
UK	101.7	107.3	2.8	0.7
EU-15(1)	100.0	100.0	2.3	1.3

Real convergence and initial per capita income



2. Macro-economic stability & public finance

Ongoing economic integration and the extension of the union-wide economic policy coordination and budgetary surveillance procedures to the new Member States helped to reinforce economic policy discipline and to achieve macroeconomic stability.

- From double-digit levels in the mid-nineties in many new Member States, inflation and interest rates have come closer to the EU-15, reflecting the overall credibility of monetary policy.
- The development of public finances has varied widely and was strongly affected by transition-related reforms. This contributed to an excessive deficit in 6 new Member States, joining an equally large number of old Member States.

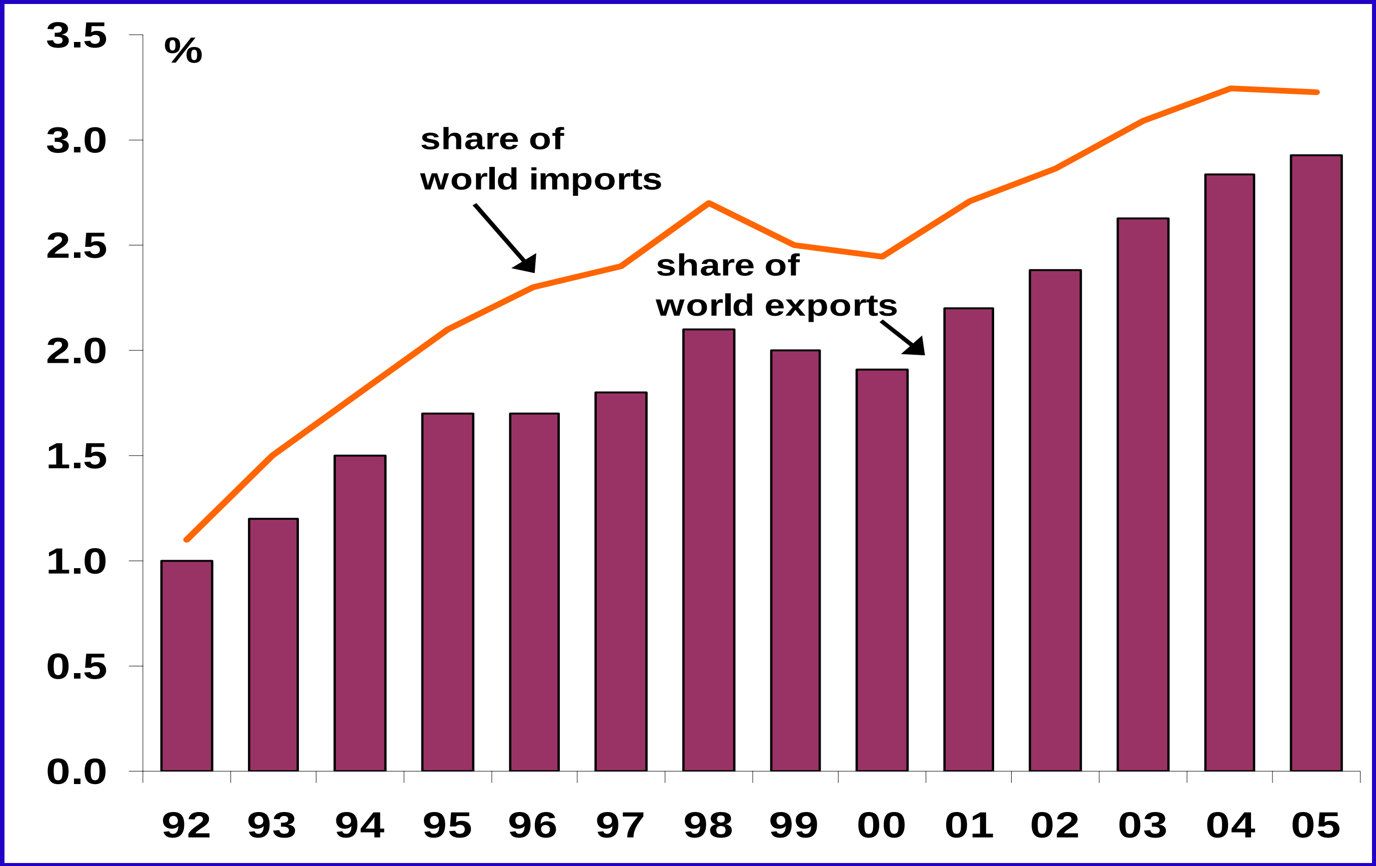
Inflation, interest rates & public finance

Countries	Inflation(2) (in %)		Interest rates (long term nominal, in %)		General Government balance (% of GDP)		General Government gross debt (% of GDP)	
	1997	2005	2001	2005	1999	2005	1999	2005
CZ	8.0	1.6	6.3	3.5	-3.6	-2.6	15.8	30.5
EE	9.3	4.1	10.2	4.0	-3.7	1.6	6.2	4.8
CY	3.3	2.0	7.6	5.2	-4.4	-2.4	59.7	70.3
LV	8.1	6.9	7.6	3.9	-5.3	0.2	12.4	11.9
LT	10.3	2.7	8.2	3.7	-2.9	-0.5	23.0	18.7
HU	18.5	3.5	8.0	6.6	-5.5	-6.1	60.0	58.4
MT	3.9	2.5	6.2	4.6	-7.7	-3.3	56.4	74.7
PL	15.0	2.2	10.7	5.2	-1.8	-2.5	39.3	42.5
SI	8.3	2.5	n/a	3.8	-2.0	-1.8	24.6	29.1
SK	6.0	2.8	8.0	3.5	-7.1	-2.9	47.4	34.5
EU-10(1)	9.1	3.1	8.1(3)	4.4	-3.2	-2.9	37.4	41.1
BE	1.5	2.5	5.1	3.4	-0.5	0.1	113.6	93.3
DK	1.9	1.7	5.1	3.4	2.3	4.9	57.4	35.8
DE	1.5	1.9	4.8	3.4	-1.5	-3.3	60.2	67.7
EL	5.4	3.5	5.3	3.6	-3.4	-4.5	112.3	107.5
ES	1.9	3.4	5.1	3.4	-1.1	1.1	61.6	43.2
FR	1.3	1.9	4.9	3.4	-1.7	-2.9	58.3	66.8
IE	1.2	2.2	5.0	3.3	2.5	1.0	48.1	27.6
IT	1.9	2.2	5.2	3.6	-1.7	-4.1	113.7	106.4
LU	1.4	3.8	4.9	3.4	3.3	-1.9	5.6	6.2
NL	1.9	1.5	5.0	3.4	0.6	-0.3	60.5	52.9
AT	1.2	2.1	5.1	3.4	-2.2	-1.5	66.5	62.9
PT	1.9	2.1	5.2	3.4	-2.7	-6.0	51.4	63.9
FI	1.2	0.8	5.0	3.4	1.7	2.6	46.7	41.1
SE	1.8	0.8	5.1	3.4	2.5	2.9	62.2	50.3
UK	1.8	2.1	5.0	4.5	1.1	-3.5	44.2	42.8
EU-15(1)	1.9	2.2	5.1	3.5	-0.7	-2.3	67.0	64.6

3. Trade performance on world markets

- **The EU-10's world market share has grown significantly over the period 1992-2003.**
- **On the export side, its share has grown from 1% in 1992 to 2.8% in 2003**
- **Its import share has grown even more strongly over the same period, from 1.1% to 3.1%.**
  - Upon enlargement, the average tariff applied by the EU-10 decreased from 8.9% to 4.1%, which is the EU average applied tariff.
- **Given the persistent out-performance on the import side, it is not surprising to find that the EU-10 has had a substantial negative trade balance over the period as a whole.**
  - the trade deficit grew from below 2% of EU-10 GDP in 1992 to between 7-8% over the period 1996-2000 before falling back over the years to 2005 to around 3%.

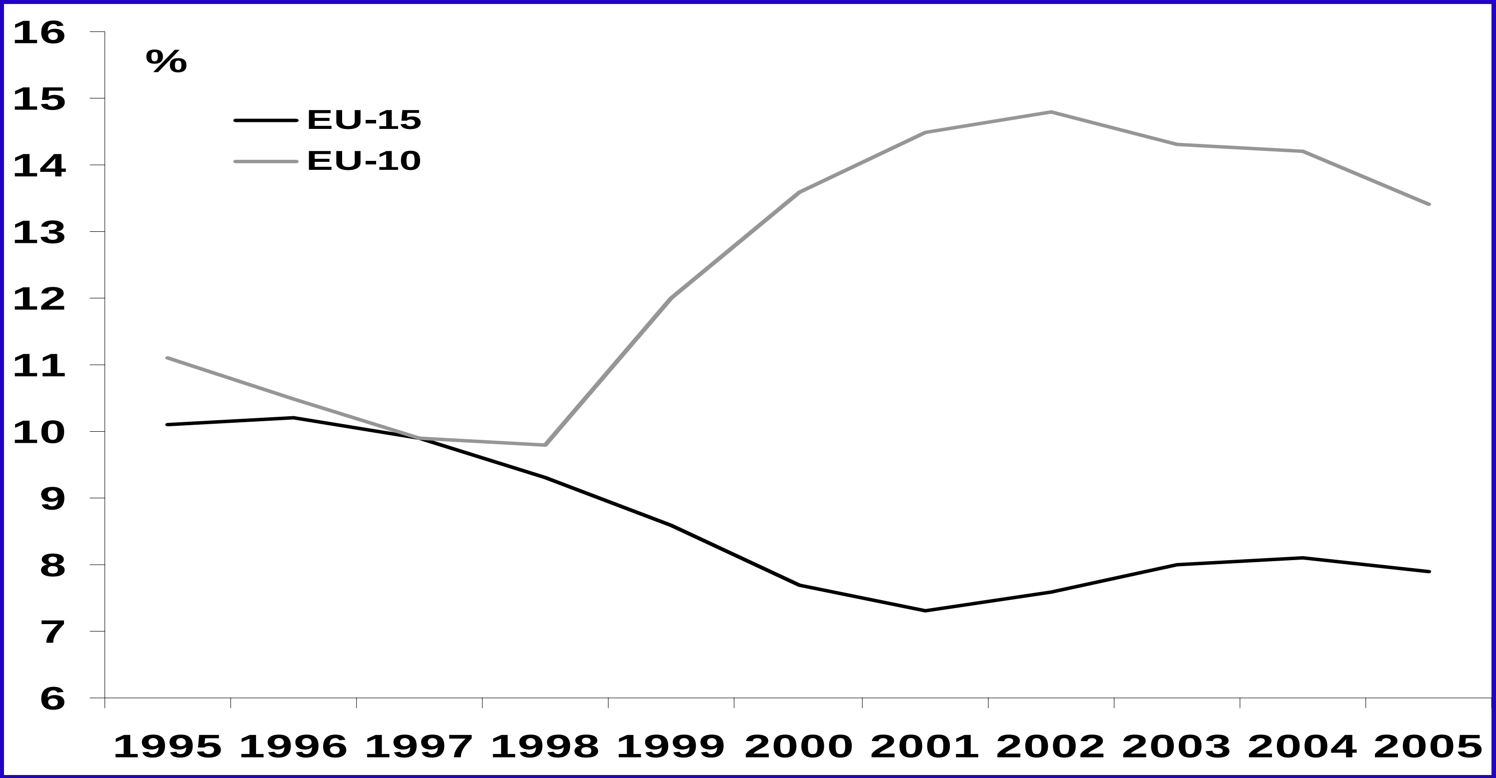
EU10's world export/import market share



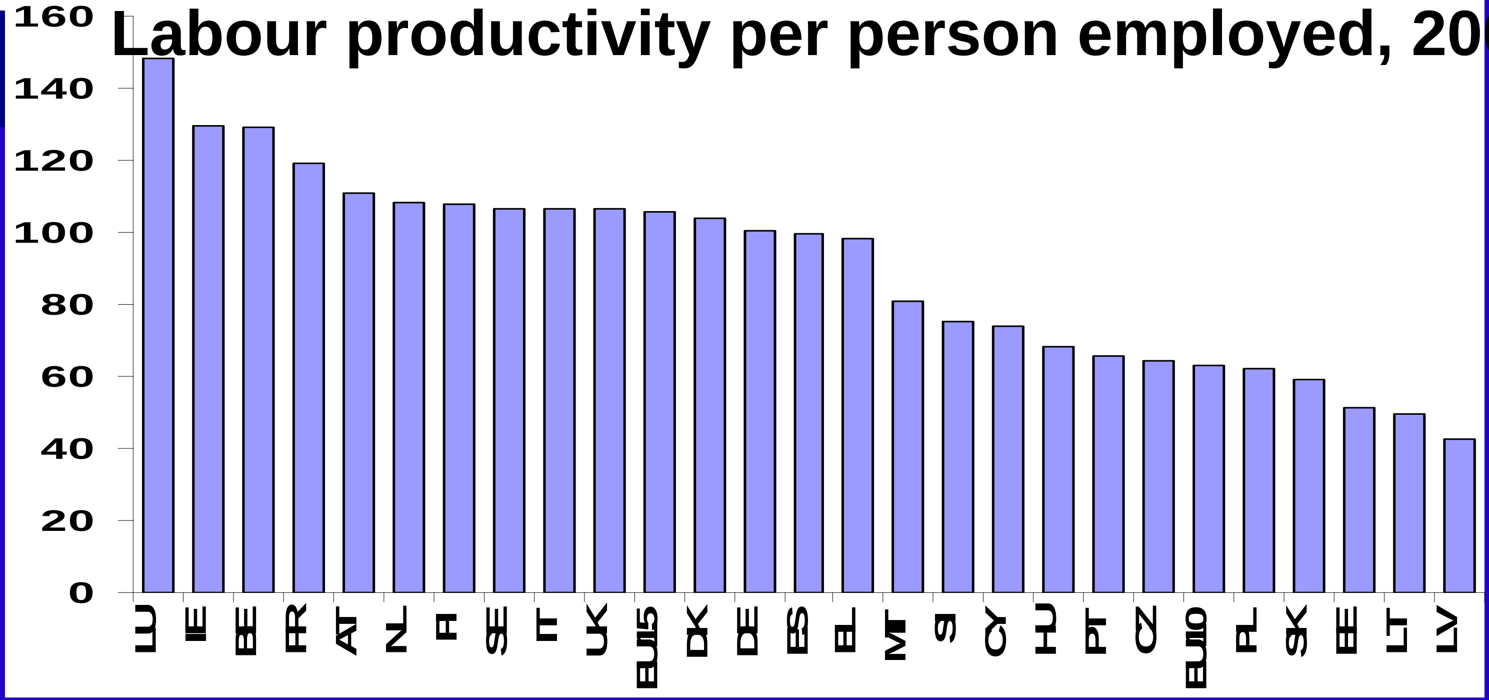
4. Labour markets in transition, but improving

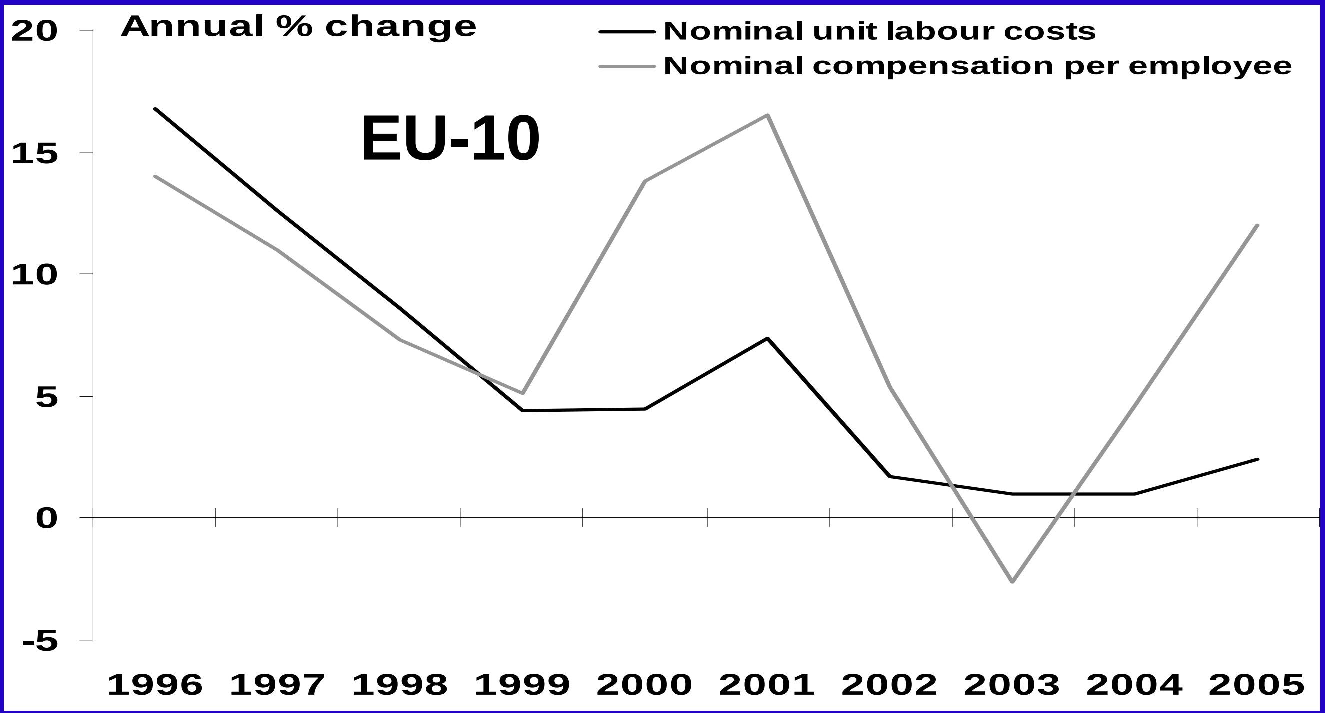
- During the 1990s, the central and eastern European Member States experienced sharp declines in employment and a rapid increase in unemployment, reflecting a combination of cyclical factors and structural adjustments.
- On the back of strong economic growth boosted by accession, employment ceased to drop in the EU-10 in 2004 and expanded by about 1% in 2005.
- However at 13.4%, the unemployment rate in the EU-10 is 5.5 percentage points above the EU-15 average, indicative of the large differences which exist across the two country groupings.
- Wide variations are also observed among the new Member States, with unemployment rates ranging from about 6% in Cyprus and Slovenia to more than 16 in Slovakia and almost 18% in Poland in 2005.

EU-10 & EU-15 Unemployment Rate



Labour productivity per person employed, 2004





5. Fears of outsourcing exaggerated

- **Labour market developments in the EU-15 have remained positive with employment growth accelerating to 0.7% in 2004 and close to 1% in 2005.**
- **A large share of the foreign direct investment by EU-15 firms going to the new Member States does not involve the substitution of activities previously carried out in the home country.**
- **This is particularly evident in services, capturing most of the foreign direct investment, where EU-10 banks target the local market and do not destroy activity in the home country.**
- **It is difficult to estimate the impact of delocalisation on employment.**
  - A Dutch country study suggests that a mere 1-1.5 % of the annual job destruction can be attributed to delocalisation (of which only a part is to the new Member States).
  - In Germany and Austria, investment in EU-10 since the early nineties had only an estimated negative employment impact of 0.3-0.7 %.

The challenges of the future

The challenges of the future

- The past catching-up experience and the strong productivity gains realised bode well for the future,
- But there remains a long way to go.
- At present growth rates it takes about 50 years to bridge the existing income gap.
- The challenge for policy making in the new Member States is to be able to sustain their competitiveness as hosts of multinational firms' activities in the long-run while promoting spillovers to consolidate the industrial restructuring and prevent the emergence of a dual economy characterised by marked performance differences between the foreign and the domestically-owned firms.
- To this end, the implementation of the structural reforms included in the Lisbon strategy namely those aimed at improving market functioning and promote the knowledge-based society is crucial.

The challenges of the future

Overall, the 2004 enlargement can be considered two years after as a landmark example of the strength of the European approach to integration.

The enlarged EU has gained in confidence and has become the ultimate objective of the political and economic ambitions of neighbouring nations.

While there is uncertainty about the extent to which the EU can absorb more member states, the prospects for further enlargements remain open

A deeper understanding has developed, that while association and ultimately membership in the EU is possible it is not unconditional – the European values of economic and democratic pluralism must first be met as preconditions to membership.

This is becoming an important catalyst for reform and for fundamental change.

Suggested readings

- Baldwin, R., J. Francois and R. Portes (1977), “The costs and benefits of eastern enlargement: the impact on the EU and central Europe”, *Economic Policy*, 24, 127-176.
- EBRD (2005), *Transition Report 2005*, November, London, available at http://www.ebrd.com/pubs/econo/6520.htm.
- European Commission (2001), “The economic impact of enlargement”, Enlargement Papers, no. 4, DG ECFIN, June, available at http://europa.eu.int/economy_finance