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## From Association to Membership: What Can Be Done by the EU to Ease Eastern Enlargement?

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# From Association to Membership: What Can be Done by the EU to Ease Eastern Enlargement?

By Christian Weise<sup>1</sup>

## Summary

*Since transformation started, ten Central and Eastern European Countries (CEECs) have negotiated Agreements of Association with the EU and have also applied for membership. This article discusses the various possibilities of the EU to help the applicants to reach this aim. Today, most attention is paid to technical assistance; financial assistance could be granted more generously. However, the really decisive yardstick for judging the EU's willingness to enlarge is not its external policies towards the CEECs but its readiness to internal reforms. The paper outlines calculations of the costs an accession of the five CEFTA-Countries would entail, with and without prior EU-reforms. Suggestions for feasible reforms are given, reforms that are even strongly advisable for the EU (15) to implement on its own, but become more urgent in an enlarged Union. Because the envisaged date for accession, the year 2000, seems to be overly optimistic and transition periods or partial memberships only offer limited solutions, it is all the more important for the EU to show its lasting commitment to an enlargement through such reforms and through more financial aid.*

## 1. Introduction

Since the change towards a democratic and market economy system, all of the associated countries of Central and Eastern Europe satisfy the fundamental conditions for European Union membership. Yet there are a number of formal and informal criteria to be taken into account in order to assess the ability of the various applicants to join the EU. It is assumed that above all the five members of the Central European Free Trade Area (CEFTA) have the chance to be the first to gain accession to the EU<sup>2</sup>. This is an important aim of the transformation process for these countries. Gaining accession to the EU would require the transformation process to be mostly finished and that a "functioning market economy"<sup>3</sup> had been established. Simultaneously, the radical change in the applicants' integration into the world economy, from the extreme protectionism of the CMEA to participation on the European internal market with the most important trading partners, would be completed.

EU membership would not only entail the end of a particular phase of development but would also facilitate even more intensive external economic integration. Political stability would increase due to the adoption of the *acquis communautaire*. As a result of this, growth conditions in general would improve and the attractiveness of the countries concerned as a location for foreign investment would increase; both effects are mutually reinforcing. Results of

regression calculations for determining a typical pattern of foreign trade also show that with common EU membership, the bilateral integration of two countries is higher than would be expected according to the other model variables<sup>4</sup>. This picture is confirmed by the experiences of the southern enlargement of the eighties<sup>5</sup>. Moreover, the effects of the internal market are now to be taken into consideration. The adoption of the competition law with common rules for public procurements, the mutual recognition of technical standards and certificates as well as the removal of border controls etc. all lower the transaction costs involved with trade. The additional welfare effects of the internal market programme, as, for example, estimated in the Cecchini Report, are indeed subject of some discus-

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<sup>1</sup> DIW. This paper was written in connection with a research project commissioned by the Volkswagen Foundation: "The Transformation of the economic system in the Central and Eastern European countries: External economic conditions and effects".

<sup>2</sup> These are Poland, the Czech and Slovak Republics, Hungary and Slovenia. In addition, Bulgaria, Romania and the three Baltic States have signed agreements of association, too.

<sup>3</sup> One of the criteria required for accession, established by the European Council in Copenhagen in June 1993.

<sup>4</sup> See DIW (1996).

<sup>5</sup> See Hallet (1995); Hohlfeld (1995).

sion as to their extent, yet within the EU a higher level of integration has definitely been reached than in the mid-eighties. Thus the additional welfare gains from participation in the EU as opposed to mere membership of a free trade zone also increase.

Due to many reasons the year 2000, often mentioned in a political context, is a somewhat optimistic estimation for the accession of the first transforming countries to the EU. On the one hand, due to the intensive integration inside the internal market demands on the applicants for accession have grown. On the other hand, even without eastern enlargement, the EU faces its own difficult tasks, which have to be solved before the acceptance of new members. The intergovernmental conference (IGC), which commenced in March 1996, has to find the answers to some urgent institutional questions (democratisation, more efficient decision making procedures etc.), the EU system of public finance will be scrutinized before 1999 and there are also still problems with the preparation and implementation of the third stage of monetary union. As opposed to that, the debate on British beef was a — striking — example of the prevailing reluctance to integrate within the EU. The accession negotiations should, if possible, start within six months of the conclusion of the IGC; however there will be no real acceleration until after a ratification of the results of the conference by national parliaments or by means of referenda. This is hardly to be expected before 1999, since, for example, the ratification of the Maastricht I Treaty took 18 months to complete. The accession negotiations took a good year for the latest enlargement of the EU and around seven years in the case of Spain and Portugal. The accession of the first new members, which again requires the ratification of the results of the negotiations by the member states, may, therefore, be more likely to occur in 2005 rather than in the year 2000.

For the EU it is very important to offer a feasible perspective of accession to avoid disappointment in the transformation countries if it seems that the date of accession will be considerable beyond the year 2000, a date that many are currently pinning their hopes on. Therefore, it has to be discussed how the EU can best help the Central and Eastern European countries with the preparation for membership, how the EU itself can prepare for enlargement, and which role transitional arrangements or partial memberships could play.

## **2. Preparation for accession: assistance for the applicants**

### **2.1 Technical help: preparation for the Community Law**

Since the founding of the European Union the set of common regulations and directives (*acquis communautaire*) has been developed extensively. Under the conditions of the common internal market, in which numerous regula-

tions were removed from EU law due to the principle of mutual recognition of technical standards, there are still many national economic institutions which in the transforming countries often had to be completely newly set up, which are to be aligned with European law. It is clear that the EU can offer valuable assistance to the applicants. The Commission presented a white paper concerning the preparation of the associated countries' entry to the internal market which is a central component of the pre-accession strategy<sup>6</sup>. This white paper is principally concerned with three questions: (a) Which regulations have to be incorporated into the national law of the countries aspiring to accede to the EU, so that they may be able to fully participate in the internal market? (b) Which of these regulations are particularly important or take a long time to introduce, and in (roughly) which order should they, therefore, be introduced to national legislation? (c) What can be done to ensure that the regulations not only formally exist but are also effectively put into practice?

Unrestricted trade in the internal market places high demands on institutions in all member states. Specific to the internal market is first of all — due to the removal of internal (economic) borders — the special responsibility with regard to the control of the Union's external frontiers. Apart from this, the principle that all goods which may be circulated in one member state are allowed to be traded in the whole community, requires that all members be able to rely on the quality controls and authorization procedures of each member state. This is independent of whether national norms are effective or whether identical community-wide regulations are still applied as in the case of food stuffs and pharmaceutical products. Many firms in Central and Eastern Europe do not currently fulfil the quality standards on imports set by the EU, for instance regarding the preparation of food stuffs. Reliable and effective EU-wide regulations are also necessary for the monitoring of competition. The enlarged market could stimulate competition distorting behaviour — be it in the form of arrangements among firms or through governments continuously giving preferential treatment in public procurement to national suppliers in the face of generally increased competition. A well structured administrative system and a reliable judiciary are not only important because community law has to be adopted by the member states but also because both are characteristic elements of a functioning market economy. To build up the necessary legal systems and above all to guarantee their effective implementation will take a considerable amount of time because the requirements for the education of the personnel are high. This is also true in the case of the transforming countries although they have, mostly, followed the example of the EU or its individual members in the rebuilding of their legal and administrative structures, and although the EU will continue to offer technical assistance to these countries.

<sup>6</sup> EC Commission (1995a); see also Mayhew (1996).

The white paper does not particularly go into the specifics of each country as it is supposed to be a general guideline for all future applicants for EU accession. The development of national white papers is now expected from these countries, explaining the stage reached in the alignment of the judiciary which may help to clarify still unsolved problems. On the EU level, a central agency will help the applicants cope with any arising difficulties and coordinate the providing of experts. The pre-accession strategy also calls for yearly Commission reports on the stage of preparation for membership reached in Central and Eastern Europe; the first — still relatively vague — report was presented to the European Council in Madrid in December 1995<sup>7</sup>.

The white paper is of great value and can help applicants for EU accession to arrange what still needs to be done to achieve full integration. The timing of membership is, however, independent of such total adoption of the EU system. The white paper is not to be seen as a listing of criteria to be fulfilled before accepting the applicants. Instead, it will help to clarify where transitional rules can be negotiated and where the internal market would be particularly affected by such rules. For instance, it is more urgent to comply with product standards than to adopt all of the directives for the production procedure. Making the adoption of all regulations a condition for membership would be to expect too much of the applicants and would have to be viewed as a — simply unspoken — rejection of eastern enlargement<sup>8</sup>.

## 2.2 Financial help: supporting economic development

The most important criterion for accession is, however, the "unwritten law" (Mayhew), according to which the ac-

ceptance of the applicants becomes easier the more successful economic development in Central and Eastern Europe appears to be over the next few years. This development is in fact already being supported by giving advice regarding the devising of a growth-stimulating economic policy, but financial help is also necessary for the building-up of institutions. In this respect, the implementation of the white paper is a question of money. The main aim of financial aid to the transforming economies is, however, the improvement of investment conditions — either by giving investing firms financial assistance or by, say, investing in the infrastructure.

The EU rapidly launched an aid programme for the transforming countries which is by no means limited to the associated states. As part of the PHARE programme half a billion ECU was available in 1990 (60 per cent of which was designated for Poland and Hungary); since 1992 the sum has been around twice as much for the Central and Eastern European states (see table 1). The members of the CIS receive support from the TACIS programme for which around half a billion was designated in 1994. The lion's share goes to Russia, the only other major recipient being the Ukraine.

For the coming years a clear rise in expenditure on the Central and Eastern European countries is planned, reaching 1.6 bn ECU in 1999 (see table 2). This too is an element of the pre-accession strategy of the EU. The increase in expenditure can be taken to be a positive signal for the

<sup>7</sup> EC Commission (1995b).

<sup>8</sup> See also Mayhew who emphasizes the danger of such an interpretation, and says that in some places the white paper was overloaded and should in these places be ignored by the applicants (1996), pp. 32 and 34.

Table 1

### PHARE: Authorized finance, 1990-1994 ECU million, current prices

	Population 1994, mill.	1990	1991	1992	1993	1994
Poland	38.6	194.6	197.0	200.0	225.0	208.8
Hungary	10.3	97.3	115.0	98.5	100.0	85.0
CSFR	15.6	31.0	99.0	100.0		
Czech Republic	10.3				60.0	60.0
Slovak Republic	5.3				40.0	40.0
Slovenia	2.0			9.0	11.0	24.0
Total CEFTA	66.5	322.9	411.0	407.5	436.0	417.8
Per capita in ECU		4.9	6.2	6.1	6.6	6.3
Total		500.0	785.0	1 015.5	1 005.3	963.3

Source: European Commission.

Table 2

**PHARE funds for CEE countries and the EU (15)'s  
structural policy, 1995-1999**

	PHARE funds		Structural policy <sup>2)</sup>	
	ECU mill.	per capita <sup>1)</sup>	ECU mill.	per capita <sup>3)</sup>
1995	1 154	9.6	24 477	264.3
1996	1 235	10.3	26 026	281.1
1997	1 273	10.6	27 588	297.9
1998	1 397	11.6	29 268	316.1
1999	1 634	13.6	30 945	334.2

<sup>1)</sup> Population of countries eligible for transfers in 1995: approx. 120 mill. — <sup>2)</sup> Cohesion fund and Objective 1 support. — <sup>3)</sup> Population of Objective 1 regions in 1995: 92.6 mill.  
Source: European Commission.

transforming countries, that the EU is continuously showing its commitment towards the development in the region. However, if one takes into consideration that for at least some of the recipients the question of acceding as early as possible is being discussed rather than future membership in general, and if one then compares the aid received by the probable future members with the transfers received by the lagging regions within the EU, a (too) large discrepancy becomes apparent. Naturally solidarity with fellow members (and contributors of funds) must be more distinct

than with third countries, even if their accession is being strived for. But the per capita contribution of 14 ECU in 1999 to the PHARE-recipients amounts to barely 4 per cent of the per capita contribution made to Objective 1 regions, the priority category of promotion in the EU. Even under consideration of the fact, that the main recipients in the EU also participate (to a small extent) in the financing of the funds<sup>9</sup>, this margin offers enough room to increase aid to Central and Eastern Europe without coming too close to the level of aid given to the EU members.

In the current phase the transforming countries are highly dependent on the inflow of foreign capital in order to renew their capital stock and to modernise the range of commodities produced, even if eventual economic development is dependent on domestic capital formation. This inflow has, however, turned out to be lower than was initially hoped<sup>10</sup>. This is partially caused by unfavourable conditions for private direct investments and by the limited number of sensible projects to be carried out. Thus, it is even more important to improve the framework for private activity with public aid programmes.

The funds provided by the PHARE programme were increasingly invested into the infrastructure as well as into vocational training and retraining (1994: 34 and 18 per cent

<sup>9</sup> See Franzmeyer/Weise (1995).

<sup>10</sup> See Jennewein (1995).

Table 3

**PHARE: Authorized finance by sector, 1990-1994  
in per cent**

	1990	1991	1992	1993	1994
Agriculture	27.2	11.3	8.4	7.8	1.8
Development of private enterprises	n.a.	n.a.	9.0	19.3 <sup>1)</sup>	9.7 <sup>1)</sup>
Finance sector	n.a.	4.5	0.5	1.5	5.8
Environment	20.5	9.9	8.9	3.2	8.0
Employment and health	2.5	10.2	5.9	6.7	4.7
Vocational training and further education	6.7	9.8	13.8	14.4	18.1
Infrastructure	n.a.	7.2	6.9	12.8	33.9
Public administration	n.a.	n.a.	7.0	8.1	8.5
Regional development	n.a.	n.a.	9.1	n.a.	n.a.
Humanitarian aid	12.4	9.3	15.4	2.0	3.1
Industry	25.3 <sup>2)</sup>	17.9	n.a.	n.a.	n.a.
SME	n.a.	6.4	n.a.	n.a.	n.a.
Miscellaneous	5.4	13.4	15.1	24.1	6.4
Total (ECU mill., current prices)	500.0	785.0	1 015.5	1 005.3	963.3

<sup>1)</sup> Industry and finance. — <sup>2)</sup> Incl. SMEs.  
Source: European Commission.

respectively); on the other hand agricultural support decreased considerably (see table 3). The orientation of the stimulus is thus similar to the focus of activity of the regional promotion programmes within the EU; its basic structure corresponds to the needs of the countries receiving aid. Sufficient quality and quantity of an economy's infrastructure is crucial for overcoming problems of development<sup>11</sup>. The improvement of the infrastructure is still a classic task of governmental economic policy even if models of private-sector financing are often sensible and if not just any infrastructure measure is to be judged positive<sup>12</sup>. In order to implement EU aid efficiently in this area one would need to take the allocation procedures of the EU's structural policy as a guideline — notwithstanding all necessary criticisms of these regional aids<sup>13</sup>. At the same time, this would serve as good preparation for the desired EU membership.

The upgrading of infrastructure lowers the transaction costs of trade, thus making it more likely that income disparities in the integration process will be narrowed. In view of limited funds the measures should concentrate on where there already is a certain demand for infrastructure. Further establishments of firms often depend on the quality and quantity of the infrastructure. Therefore, the encouragement of private investment as well as involvement in public infrastructure measures can and must supplement each other.

Data on the current condition of the infrastructure in the transforming countries is inconsistent and in some place relatively old. The available details, however, indicate that there are considerable deficits. This partially refers to the number of available facilities, but even more so to their quality. Reasons for this can be seen to be, among others, the high level of vertical integration in production and the low significance of private car ownership during the planned economy era<sup>14</sup>. Particularly underdeveloped is the road network. Telecommunication facilities at the beginning of the transformation were certainly in a poor state; however, due to technical reasons and because it is feasible and sufficient to concentrate on supplying businesses in the first instance, a relaxation of the situation — and an important role of the private sector — is possible. In order to ease bilateral trade and to promote economic development in Central and Eastern Europe, simply looking at the basic infrastructures (railways, roads, telecommunications) is certainly not sufficient. The elimination of certain bottlenecks is of much higher importance. This refers to, for example, processing and storage capacities in the food sector as well as to the establishment of centers for the distribution of goods and of facilities for combined transportation ("modal split" between railways, roads, and waterways). There certainly exists a considerable need for environment-related infrastructure to be improved (increased efficiency in energy production, a decrease in losses in the mains system, i.e. for water and gas etc.). This too influences more or less directly the conditions for investment.

A special task for the EU consists in the incorporation of the Central and Eastern European countries into the Trans European Networks (TEN), the construction of which is a current focus of work in the EU and, moreover, in the promotion of cross border infrastructures between the transforming countries. Integrating the associated countries into the TEN has already been tackled; however, the implementation of the initiatives — and of the East-West connections in particular — are apparently only making slow progress. The promotion of bilateral, cross-border infrastructure would correspond to the EU's drive towards a high level of inter-regional cooperation between the applicants for EU-accession. In a way, measures of this kind are a logical element of an economic policy strategy, that concentrates on the elimination of economic barriers and the integration of national markets. In addition to this, they would also bring about political advantages. They lend credibility to the emphasis which the EU lays upon the Visegrád Process. They foster cooperation among the Central and Eastern European countries and facilitate their bilateral economic integration. Above all, a closer physical connection between the EU and Central and Eastern Europe — combined with more intense cooperation and higher financial activity of the EU — would show the applicants that the prospect of EU membership is realistic.

Investments in human capital are a further important factor for economic development, alongside the promotion of a physical infrastructure. The Central and Eastern European countries can build up on a good foundation here. A change in the comparative advantages of Central and Eastern Europe (i.e. a reduction in the current disadvantages in research-intensive goods) is not only desirable but also quite possible<sup>15</sup>. It is also clear that such a development depends on the conveying of specific human capital and on investments with which the existing technical gap could be narrowed.

Unused or insufficiently developed human capital quickly goes out of date and becomes worthless. Maintenance of the infrastructure must be continuously carried out in order to prevent future modernisation costs from shooting up. Likewise, the efficient elimination of environmental damage needs to be done quickly. Due to all of these reasons, the EU would be ill-advised if it were to delay a clear extension of its support until after full membership has been achieved. The costs arising from this may well lie way beyond the amount currently required. Of course not every transfer to the applicants is economically sensible per se, but parallel to the current political preparations for accession a considerably higher amount of financial activity should be possible than is planned for at present.

<sup>11</sup> See for example World Bank (1994); Bach et al. (1994); OECD (1994).

<sup>12</sup> See Hurst (1994).

<sup>13</sup> See Weise (1995).

<sup>14</sup> See Mayhew (1996), p. 20.

<sup>15</sup> See Trabold/Berke (1995, 1996).

### 3. Preparation for accession: reform of internal EU policies

The preparation for the accession of several Central and Eastern European countries is a serious challenge, not only for these countries but also for the EU itself. Firstly, this concerns the institutional system of the Union which, independently of eastern enlargement, is under scrutiny in any case. The acceptance of new members increases pressure to make decisions — for example with regard to the number of official languages. Apart from this, another problem is, for example, the size of parliament which on the one hand should not become too large whilst on the other hand the representatives should not have to represent too large a constituency. A similar dilemma, that of finding the optimal size of the institution on the one hand, and the necessity of all the member states being sufficiently represented on the other, exists in the case of the European Commission. In particular, the sovereignty of the member states is touched upon in the question of the decision-making procedure in the European Council. If further integration is not to be made too difficult, one will have to move more in the direction of majority voting. In the interest of a balanced and transparent procedure the principle of a double majority presents itself, in which decisions are reached only if a majority of governments simultaneously represents a majority of the EU population. Finding the solution to these problems, which cannot be pursued here, is the task of the current intergovernmental conference on further development of the Maastricht Treaty.

Whilst the institutional questions are not at all caused by eastern enlargement, this is not the case for the budgetary effects of the incorporation of various transforming countries. The first question to ask is how large these effects would be regarding the acceptance of unchanged EU internal policies. Here, it turns out that modifications of these policies become necessary which in turn also have repercussions on the budget for the EU (15).

The actual budgetary costs of an enlargement depend on numerous parameters which are still too uncertain to make reliable estimates with. The following can only provide a framework for debate and show the direction for future reform. Above all, the quantitative statements made are dependant on assumptions of the time of accession, macro-economic development and the choice of the primary applicants for accession. It will be assumed that the year of accession is the year 2000 as this date characterizes the enlargement debate and the further integration of the markets should not unnecessarily be delayed. The open questions which arise in this context will presumably somewhat delay the accession alongside the internal EU obligations mentioned in the introduction, as solving them requires time. A constant GDP growth rate of 2.0 per cent will be assumed for the EU (15). The applicants may show a clearly higher — albeit gradually falling — growth rate; until the year 2000 it will amount to a good 4 per cent. All quantitative statements are made with reference to

an accession of the five CEFTA countries Poland, Hungary, the Czech and Slovak Republics and Slovenia.

### 3.1 The direct budgetary effects of a CEFTA (5) accession

#### 3.1.1 Structural policy

The EU structural policy has gained considerable political importance and financial muscle over the last ten years. First and foremost, the measures should improve chances of development for the "less privileged" regions in the Union<sup>16</sup>. The funds for this policy area are now the second most important item of the EU budget; by the end of the decade they will make up around 35 per cent of the total budget. The structural policy costs from fully applying the current regulations to the acceding countries can be relatively accurately estimated. All countries in question have a per capita income which is clearly lower than that of the poorest EU member (see table 4). They qualify without doubt for the support within the framework of Objective 1, the priority category in the EU's system of aid<sup>17</sup>. Criteria for the distribution of funds to the support areas are, according to the fundamental regulation, national prosperity, regional prosperity, the population level in the region and the extent of the problems<sup>18</sup>. Under equal treatment, the inflows to the new members will hence arise according to their national prosperity and the relationship between per capita income and per capita aid in the so-called cohesion countries in the EU (15) which, like the new members, are almost completely regarded as Objective 1 areas. These are Spain, Portugal, Greece and Ireland. The latter is not taken into account in the estimation of transfers to the CEFTA (5) because Ireland, the most prosperous of the four countries, receives the highest amount of inflows, which does not seem to be a systematically sensible principle for aid<sup>19</sup>. Calculated this way, the CEFTA (5) would receive per capita aid to the tune of around 500 ECU (all ECU figures at 1992 prices), all in all the countries would receive a good 33 bn ECU from the structural fund. This would be somewhat more than the amount expected for the year 2000 for this policy area in favour of the EU (15).

<sup>16</sup> See Abraham/van Rompuy (1992); Weise (1995).

<sup>17</sup> Criterion to qualify for support is regional per capita income of less than 75 per cent of EU average. Although this average will fall when clearly poorer states accede it is assumed that the EU (15) average will continue to be taken as a yardstick in the future. Otherwise many current recipients would be no longer eligible for aid and the enlargement would hardly get the unanimous vote needed.

<sup>18</sup> Art. 12 (4) of the reformed EEC Regulations No. 2052/88, of 20.07.1993.

<sup>19</sup> See CEPR (1992); Baldwin (1994). Ireland has nowadays — measured in purchasing power parities — a per capita income above 75 per cent of the EU's average. Thus, the transfers have to be scaled down in due time; an abrupt end of the inflow of funds does not seem probable.

Table 4

EU and CEFTA GDP per capita<sup>1)</sup>

	ECU purchasing power parities	EU (15) = 100			
	1993	1993	1996	2000	2005
Luxembourg	25.422	160	160	160	160
Belgium	17.946	113	113	113	113
Denmark	17.815	112	112	112	112
Austria	17.718	112	112	112	112
France	17.434	110	110	110	110
Germany	17.147	108	108	108	108
Netherlands	16.308	103	103	103	103
Italy	16.228	102	102	102	102
United Kingdom	15.717	99	99	99	99
Sweden	15.590	98	98	98	98
Finland	14.387	91	91	91	91
Ireland	12.826	81	81	81	81
Spain	12.330	78	78	78	78
Portugal	10.935	69	69	69	69
Greece	9.998	63	63	63	63
EU (15)	15.879	100	100	100	100
Slovenia	7.697	48	52	56	61
Czech Republic	7.507	47	50	55	60
Slovak Republic	6.367	40	43	46	51
Hungary	5.967	38	40	43	47
Poland	4.838	30	33	35	38
CEFTA (5)	5.635	35	38	40	45

<sup>1)</sup> GDP growth is assumed to be 2 per cent for the EU and ca. 4 per cent for the CEFTA.

Sources: European Commission; DIW calculations.

Expenditure of this level resulting from an eastern enlargement would probably have a prohibitive effect. They would also not be economically wise. On the one hand, in its structural policy the EU needs to concentrate on fewer instruments and increase the efficiency of the remaining measures anyway (see section 3.2). On the other hand the absorptive capability of the recipient economies has not yet been taken into account in the calculations of the inflow of funds. Yet this is a very decisive question. The transfers derived above would make up around 7 per cent of the GDP of the recipient countries<sup>20</sup>. Since the EU exclusively co-finances national measures — public infrastructure projects or promotion of private investment — and the share of the member states should increase in the future, significantly higher proportions of GDP would be spent in the framework of the support scheme. The administrative capacities for a reasonable implementation of transfers of that size would definitely not be available. The high share of non-market guided investments could hardly be supported in economic policy; inflationary pressure would increase. One cannot determine an objectively correct threshold. Today, there are already signs that individual member states have reached the boundaries of their absorptive capabilities. It is proposed here to take the proportion of

transfers to GDP as probably reached in the cohesion countries by the end of the decade as a guideline, and to limit aid to 3 per cent of GDP. The structural policy transfers to the CEFTA (5) would then be reduced to almost 15 bn ECU. The funds to be used here would initially increase parallel to GDP growth until the claim for funds resulting from the per capita income has fallen below the threshold of 3 per cent of GDP.

### 3.1.2 Agricultural policy

Expenditure on agricultural policy still takes up the largest share of the EU budget, even though its importance has lessened in recent years. Here, the costs caused by the accession are particularly difficult to assess. Firstly, the factors influencing the size of the payments are more numerous and more complex than with structural policy. Secondly, the development of the agricultural sector in the Central and Eastern European countries is uncertain; however, in view of the serious weaknesses in productivity

<sup>20</sup> This value seems lower than other figures published occasionally. But here the GDP (and the per capita income) is measured consistently in purchasing power parities.



Table 5

**Budgetary costs of EU eastern enlargement regarding the adoption of the 1992 reformed CAP**  
(in ECU billion)

	Visegrád-countries <sup>1)</sup>	Baltic states <sup>2)</sup>	Total	Year of accession
Anderson/Tyers (1993)	37.6	—	37.6	2000
Baldwin (1994) <sup>3)</sup>	11.7	11.6	23.3	
Tangermann et al. (1994)	13.3	6.0	19.3	2000
Mahé et al. (1994) <sup>4)</sup>			12.2	2000
			16.1	2005
			8.5	2005
UK-MAFF (1995)	14.0	—	14.0	
EC Commission (1995d) <sup>5)</sup>			9.0	2000
			11.7	2005
			12.2	2010
Steichen (1995)			5-6.5	2005
LEI (1995)	7.0	—	7.0	2000

<sup>1)</sup> Poland, Hungary, Czech Republic, Slovak Republic. — <sup>2)</sup> Romania, Bulgaria. — <sup>3)</sup> CAP-Reform not taken into account. — <sup>4)</sup> The costs of accession vary according to assumptions on adjustment of agricultural policy after 2000 and on interim periods. — <sup>5)</sup> Incl. Slovenia and the Baltic states.  
Source: Compiled by DIW.

and in the quality of the products, fears often voiced certainly seem to be exaggerated. Thirdly, it is unclear how the EU agricultural policy will look at the beginning of the next decade; pressure for reform does not arise only because of eastern enlargement but also due to internal fiscal restraints and the world trade talks.

The European Commission has commissioned several studies towards analysing the effects of eastern enlargement and has published its own position in a white paper<sup>21</sup>. Numerous further studies have been published<sup>22</sup>. Depending on the approach the individual studies come to very different results (see table 5). The consequences of reforming the EU agricultural policy were often taken into account, but not so the effects of the WTO agreements. Partly, developments in production are taken for granted which clearly have to be regarded as overly optimistic and which entail subsidies — in the models — for which there is no foundation in foreign trade policy.

It is not possible to comment on each individual study or even make a detailed assessment of them at this place. One can get an impression of the magnitude of the burden caused by fully transferring the agricultural policy onto the new members if one assumes that the budgetary costs have a constant relationship to gross value added in agriculture. Additionally, it is necessary to note that the price level for agricultural products in the Central and Eastern European countries is considerably below that of the EU. Participation in the single market requires that the two be aligned as the removal of internal borders is not com-

patible with differing prices — under the status quo assumption for the EU (15) this requires an upward-shift of prices in Eastern Europe. Enlargement by the five CEFTA states would thus entail annual costs of almost 7 bn ECU as a result of agricultural policy.

An analysis of the theme of agricultural policy and eastern enlargement must go beyond this first approach. EU agricultural policy is currently undergoing reform which until now has touched on only individual market regulations. The reform should be furthered now in connection with the planned continuation of the world trade negotiations. Therefore an overall alignment of EU agricultural prices to the world price level is all the more required since the agricultural prices in Central and Eastern Europe are below those of the EU. In a single market the law of one price is applicable and pushing up the prices in Central and Eastern Europe up to the EU level would be socially unjustifiable and absurd in general economic reasoning.

The first round of the reform is concluded by the end of the financial year of 1996. The conventional costs in market regulations (reimbursements, interventions, storage costs) only come to 15 per cent in the reformed areas. The rest is allocated to price equalisation payments as compensation

<sup>21</sup> Buckwell et al. (1994); Mahé (1994); Tangermann et al. (1994); Tarditi/Marsh (1994); EC Commission (1995d and 1995e).

<sup>22</sup> See for example Anderson/Tyers (1993); Baldwin (1994); LEI (1995); Steichen (1995); UK-MAFF (1995).

to farmers for the loss of previous subsidies. First of all, there is no reason to pass this part of EU agricultural policy on to the new members as the farmers there do not have to bear any drop in price through their accession. A partial adoption such as this would certainly only be possible for the EU if the agricultural policy was restructured further (see section 3.2). If we come to an agricultural reform which encompasses all products and only the conventional costs of market regulations are being paid in the new member states, then the costs of agricultural policy following eastern enlargement would fall dramatically. In this case they would merely be 1 bn ECU.

### 3.1.3 Net costs

In order to establish the net costs, the costs not arising from structural and agricultural policy and the contributions of the new members to the budget are to be taken into consideration as well. The other costs are marginal and will not be pursued further here: expenditure on administrative tasks and internal policy areas such as, for instance, research promotion, will increase whilst the funds for external policy areas will fall by the aforementioned aid to the new member states.

The EU members' contributions to the budget are the result of a very complicated system<sup>23</sup>. First of all, the so-called traditional own resources (agricultural levies, levies on sugar and isoglucose products, customs duties) flow

into the EU; they make up around 20 per cent of planned expenditure. The largest source of income is the value added tax own resources (a good 50 per cent), for which the member states take off a standard 1.4 per cent of the harmonized value added tax base. A cut-off limit is intended to counteract the regressive effects of a too strong orientation to the value added tax base. By 1999 this limit is planned to approach 50 per cent of GNP, i.e. the VAT base for calculating the contribution will only be used up to this level. To finance the remaining difference between planned expenditure and prospective income, the members pay a standard share of their GNP, the so-called GNP own resources (around 30 per cent of the budget). This system is unnecessarily complicated. Recording the flows to the budget as "own resources" cannot disguise that the payments made by the member states are contributions and that it is not the EU who has control over its inflows. It would be consistent and more transparent to openly change to a solution with "contributions". As a result, the structure of the payments made by the member states — above all due to the effects of the cut-off limit — are already very similar to the country pattern of the GNP (see table 6). The only exception is the United Kingdom for which an exemption clause exists so far as to the financing of the budget. The contributions of the new members are in any case here estimated to be a fixed proportion of their GDP. This would amount to around 6.5 bn ECU.

<sup>23</sup> See Peffekoven (1994).

Table 6

**Distribution of EU-GNP and financing of EU budget by member states**

	GNP according to plan for the financial year ...			Total finance for the financial year ...			Finance without tradi- tional own resources for the financial			Total traditional own resources (net) for the financial year ...		
	in per cent			in per cent			in per cent			per cent		
	1994	1995	1996	1994	1995	1996	1994	1995	1996	1994	1995	1996
Germany	29.2	28.1	28.1	30.4	29.3	30.0	30.8	30.0	30.6	28.9	26.7	27.4
France	19.7	18.2	18.0	19.3	17.9	17.6	20.9	19.0	19.2	13.7	13.4	10.6
Italy	15.8	13.5	13.6	14.2	11.6	12.1	15.4	12.5	13.1	9.4	8.0	7.7
United Kingdom	13.7	13.9	13.9	11.6	12.7	10.8	9.8	11.4	9.2	18.6	18.0	18.3
Spain	8.2	6.6	6.5	8.1	6.3	6.4	8.9	6.8	6.8	5.1	4.6	4.4
Netherlands	4.7	4.5	4.6	6.3	5.8	5.8	5.0	4.8	4.9	11.1	9.8	10.0
Belgium	3.2	3.1	3.2	4.0	3.8	3.8	3.3	3.1	3.2	6.6	6.4	6.6
Luxembourg	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.1	0.1	0.1
Sweden		2.6	2.6		2.5	2.9		2.5	2.6		2.4	4.3
Austria		2.7	2.7		2.7	2.9		2.8	2.9		2.2	2.7
Denmark	2.0	2.0	2.0	2.0	1.9	1.9	1.9	1.9	2.0	2.1	1.8	1.8
Finland		1.4	1.5		1.4	1.5		1.4	1.5		1.3	1.7
Portugal	1.4	1.2	1.3	1.6	1.5	1.5	1.6	1.4	1.5	1.9	1.6	1.6
Greece	1.3	1.3	1.4	1.5	1.4	1.5	1.5	1.5	1.6	1.5	1.2	1.1
Ireland	0.6	0.7	0.7	0.8	1.1	0.9	0.7	0.8	0.8	1.1	2.5	1.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Budget plans 1994, 1995 and 1996, OJ of the EC L 34/1994, L 369/1994 and L 22/1996; DIW calculations.

The net costs of enlarging the EU by the five CEFTA states therefore amount to around 33 bn ECU with full adoption of existing structural and agricultural policies. If the absorptive capabilities of a national economy for transfers relating to structural policy are taken into account in the future and if the common agricultural policy is not completely adopted in its entirety then the expenditure on the new members will drop from about 40 bn ECU to 15 bn ECU. Net costs of under 10 bn ECU would remain.

### 3.2 Changes to the EU (15) budget

Eastern enlargement also requires changes to the policies which are carried out in favour of the EU (15). On the one hand this is a result of the measures recommended in section 3.1, on the other, the net costs of the enlargement are quite high, even if they can be restricted as outlined above, and they give cause for renewed examination of the EU's activities on inefficiencies or lacking concentration.

#### 3.2.1 Structural policy

The proposed upper limit for structural policy transfers to a member state has no direct effects within the EU (15). However, it is important to point out that they make it impossible that the significant increase of the budget for structural policy of the previous years continues. Regardless of eastern enlargement, a consolidation phase is necessary after doubling the funds for the most needy regions both in the last and in the current period of promotion. It is now important to consider more carefully the principle of the concentration of funds, which was an element in the reform of structural policy in 1988. This point is also stressed by the Commission; however, it is obviously not prepared to go far enough<sup>24</sup>. It stresses that disadvantaged regions in prosperous member states should receive further support. The central problem with the common structural policy running today is yet exactly — and this may well be mainly due to political reasons or negotiating tactics — that the instruments of promotion were expanded too far and that all union members now receive help. According to the principle of subsidiarity a restriction to those regions would be necessary which cannot satisfactorily develop by themselves or within the framework of national regional policy.

Objective 1, which is directed towards regions which are particularly underdeveloped compared to the EU average, is well founded both economically and with regard to integration policy. It is also defined by means of convincing quantitative criteria. With very few exceptions the remaining instruments do not fulfil these conditions<sup>25</sup>. The promotion of industrial regions in decline (Objective 2), the battle against youth and long term unemployment as well as preventive labour market policy (Objectives 3 and 4), the development of rural areas (Objective 5) and sparsely populated areas (Objective 6) can be seen as the respon-

sibility of economic policy. However, the member state is the appropriate actor: the problems neither arise through European integration nor is there any convincing economic justification for a common policy to be applied. In addition, quantitative criteria for promotion policy are almost completely missing. This extensive promotion is not acceptable — especially not in times when considerable funds are necessary for decisive steps towards integration. Dismantling the criticized instruments would above all affect the prosperous member states.

Independently of such a regional and functional concentration of activities, the efficiency of the remaining measures deserves particular attention. To this end four approaches are possible. First of all, the share of the structural funds in the financing of the supported projects — it currently amounts to up to 75 per cent in the Objective 1 regions — need to be reduced in order to increase the financial responsibility of the individual member state. Additionally, the control and sanction mechanisms have to become more effective; this is shown in the relevant reports by the European Auditor-General's office (the most recent being for the financial year 1994)<sup>26</sup>. Furthermore, it is to be considered more seriously that the success of the EU transfers is largely dependent on the accompanying national economic policy. Finally, it should be possible to award at least a part of the funds in the form of cheap loans and not as a grant.

#### 3.2.2 Agricultural policy

Without doubt, serious changes of agricultural policy are on the agenda. Firstly, the reform already commenced must be continued rigorously. Judged by the results regarding the already reformed market regulations, around 85 per cent of the budget for agriculture was spent on price equalization measures and therefore served as compensation for the loss of previous subsidies. Apart from the fact that this compensation is often criticized as being not very well targeted<sup>27</sup>, to pay such compensation for a long period of time is naturally not compatible with a market economy. To a certain extent transfers to farmers are possibly justifiable — for instance due to positive external effects of protecting cultivated land. It could, however, prove to be difficult to quantify this share. The predominant share of the price equalization payments will in any case have to be reduced in the foreseeable future due to economic reasons<sup>28</sup>. Should this not occur, or only hesitantly so, then there is another aspect to be noticed. Today, compensation payments are linked to factor inputs; therefore they still have a distortive effect on competition. Because of this, it

<sup>24</sup> See EC Commission (1995c), § 41.

<sup>25</sup> See Weise (1995).

<sup>26</sup> In: OJ of the EC C 303, 14.11.1995.

<sup>27</sup> See Zimmermann/Zeddies (1996).

<sup>28</sup> See Henrichsmeyer (1996).

would not be justifiable not to transfer this part of the policy onto the new members — as was suggested above — but to leave it unchanged in the EU (15)<sup>29</sup>. The second best solution, if there is not sufficient political power to cut the transfers, would be to change the price equalization payments into direct income support within the EU (15). Of course, an income support payment has to be seen more as a part of social policy than of agricultural policy (with the exception mentioned above). According to the principle of subsidiarity, this should therefore be transferred back to the member states.

### 3.2.3 Budget

The suggestions for modification developed here have effects on the EU (15) budget. The structure of raising the money should change in two ways. Firstly, in the future — after a CAP-reform — the British reduction in contributions will no longer be justifiable — regardless of whether it is in fact based on convincing grounds at the time, such as the characteristics of the United Kingdom's agricultural markets. Secondly, one should seek to adopt a rigorous solution, according to which member states' contributions to the EU budget are proportional to their GDPs. Such a solution would be more transparent and, therefore, more convincing to EU-tax payers without changing the structure of financing the budget dramatically.

Reductions in expenditure result in structural policy and — possibly — in agricultural policy. The recommendable reduction of common activity will only gradually be put into action; even after carrying it out the member states will still place a part of the funds previously necessary for financing EU measures into equivalent national programmes. The result will be — most probably — real savings for the member states because the reforms will lead to more efficient instruments and because the volume of the subsidies will become more obvious if they are organized on the national level. This, in turn, should lead to political pressure to reduce the payments. The amount of real savings, however, as well as the time the savings are made is uncertain. The EU budget plan for 1999, however, conveys an impression of the financial volumes involved. Excluding Objective 1, around 8.5 bn ECU are intended for structural policy purposes. A total of almost 40 bn ECU is planned for agricultural policy; after a fully transferred reform — measured by existing experiences — around 34 bn ECU would be allotted to price equalization measures and would be affected by further reforms (reductions, restructuring and/or retransfer).

In other areas, higher costs are to be expected. The recommended measures — above all in agriculture — would also have painful effects on less prosperous member states. In all probability this would have to lead to compensation. Apart from this, the EU will have to make considerably higher payments to third states in the medium term, compared to what it has been used to in the past. This

concerns necessary help for the associated countries which are to accede later and for other Central and Eastern European countries as well as help for rebuilding in ex-Yugoslavia and the Middle-East, and also the funding of the Mediterranean policy. The total funds necessary for this cannot be predicted reliably.

With stronger concentration of EU measures and with reforms which are — from an economic point of view — imperative anyway, not only should the direct costs of eastern enlargement be limited but also considerable funds of the EU budget could be released which then could be made available for enlargement and increasing demands of external policies. Payments of member states to the EU budget would not necessarily fall as a result, in fact the burden on the budget might be higher — depending on the extent, to which the individual member state pursues the re-transferred former common policies at the national level. However, the return on their investments would be higher: an enlarged and more efficient Union, which is a (officially stated) political aim on its own and which will provide a framework for intensified trade relations and more stable economic development in the future.

## 4. On the problem of transitional rules and partial memberships

For EU membership, participation on the internal market is constitutive. This does not rule out transitional arrangements in particular cases, but does exclude permanent non-participation in particular elements of the EU policies. In view of — putative or actual — difficulties in adopting the *aquis communautaire*, a solution may be to dissolve the level of Community law achieved: whether it concerns freedom of movement, the control of competition or agricultural policy. But then the EU would lose its character as a highly integrated community of states. The EU's formula for success is to guarantee political stability through economic interdependence and to maximize the prosperity of the national economy by (at least striving to) exhausting the advantages of internal liberalisation — cushioning any hardship that may arise. If eastern enlargement were to be bought with abolishing a common finality for the members its price would be too high for current members and the reward too low for new members. The European Union is not a symbolic amalgamation of economically independent nations. The integration of the Central and Eastern European applicants into the pillars of the Union, which are (still) organized purely intergovernmentally (i.e. Common Foreign and Security Policy, cooperation in the fields of justice and home affairs), is at best an element of the pre-accession phase<sup>30</sup>, the political problems of which cannot be discussed in detail here. In any case, it would be fatal if, through integration of this kind,

<sup>29</sup> See Tangermann et al. (1994).

<sup>30</sup> Seiters (1996); also see Kornai (1996).

membership in the first pillar, the European Community as the economic center of the integration process, would gain less attention.

Transitional arrangements with clear deadlines can, on the other hand, help to ease accession provided certain principles and dangers are taken account of. The first principle is having a clear deadline. An opt-out clause such as in the case of the United Kingdom or Denmark is only conceivable for members who, in extreme cases, could block further integration. Applicants do not have this option. Secondly, transitional arrangements must satisfy the prohibition of discrimination (Art. 6, EC Treaty), according to which all citizens of the EU are to be treated equally<sup>31</sup>. Thirdly, transitional arrangements should be compatible with the basic principles of the internal market. Above all, this means that they may not require that border controls continue. A comparison of the eastern with the southern enlargement with its extensive and long term transitional arrangements does not take into account the changes in the EU since the first half of the eighties.

On the one hand, the dangers of transitional rules lie in the unclear distinction between long term adjustment periods and permanent exemption clauses. There is a danger for the applicants to effectively get stuck as a second class member, which they want to avoid at all costs. On the other hand, transitional arrangements can ease the need to solve the problems. The pressure for reform which goes along with eastern enlargement can actually be quite beneficial, both for the applicants and for the EU.

In which areas transitional arrangements will finally be required will not be known completely before the accession negotiations — above all because the *aquis communautaire*, to which all new members have to adjust, is partially still unknown. Certainly, the proportional connection between desired transitional arrangements and the necessary duration of the negotiations needs to be borne in mind. The applicants can, however, contribute to keeping the negotiations brief. To that end, they must work out as early as possible in which specific areas they have difficulties in directly adopting the *aquis communautaire*. This mainly affects the preparation for the internal market for which the EU is already offering valuable technical help. It would surely ease the negotiations significantly if it were possible for the applicants to develop common positions.

Some consequences of the plans for monetary union are also foreseeable for the applicants. They do not have to meet the convergence criteria at the time of accession and would indeed be ill-advised to strive to do so rapidly. From today's point of view, the main source of problems are the monetary criteria (inflation, interest rates); however, it cannot be taken for granted that the still thoroughly favourable situation regarding the fiscal criteria is going to be permanent. In the near future the transforming countries will belong to the group of nations to which a special regulation

applies (Art. 109k, EC Treaty). Much more important than satisfying the criteria may be the political, technical and legal requirements which result for all members from the Maastricht Treaty. This includes the prohibition of states having priority access to the financial institutes, anti-inflationary monetary policy and productivity-oriented wage policy.

## 5. Conclusion

The public debate on eastern enlargement often lacks realism. On the one hand overly optimistic schedules for accession are put forward and the problems which come with EU membership (keyphrase: sacrifice of sovereignty) are rarely openly put on the table; this involves the danger of disappointment and possibly lays the foundation for later feelings of resentment towards the European Union. On the other hand, deterring scenarios of too excessive burdens on current EU members following an accession are also presented.

The applicants should develop common positions and policies as extensively as possible. This would reduce the number of problems still to be solved in the accession negotiations, rehearse the need to find a compromise, which is typical of the EU, and at the same time guarantee the EU that further integration will not be hindered by bilateral tension between the Central and Eastern European countries<sup>32</sup>.

Occasionally, the EU's insistence on recommending intra-regional cooperation is misconceived in the transforming countries as implying that the applicants should be satisfied with a provisional solution. Particularly because accession probably will not occur until around the year 2005, even in the case of the most advanced Central and Eastern European countries, it is important to lend credibility to the accession perspectives in order to avoid frustrations in Eastern Europe and the risk of a severe set-back in the European integration process.

A contribution to this could be an expansion of EU's financial help to the CEECs. This would show the applicants that the Union is lastingly committed to an enlargement. The support payments to non-members will certainly always be less than those to members. According to the plans that are being put forward, the difference in the intensity of support is so considerable, that there is still room for a clear increase in aid for Central and Eastern Europe, without clouding the distance to the Objective 1 payments within the EU. There are plenty of opportunities for a sensible use of funds; after accession the new members can assert considerably increased claims in any case. The earlier the due support is given — although before an accession only on a relatively limited scale — the larger its effects will be.

<sup>31</sup> However, there will be, most probably, some temporary discriminating arrangements regarding free movement of labour.

<sup>32</sup> See EC Commission (1995c), § 14.

On the other hand, the yardstick for testing the EU's readiness and capability to enlarge is the commitment it shows with internal EU reforms. Eastern enlargement offers an opportunity to carry out long needed modifications. In particular, this would have to lead to a concentration on fewer activities and an increase in the efficiency of the remaining

ones. Without such changes considerable costs could indeed result from eastern enlargement which could impede, and possibly even prevent the acceptance of new members. For the necessary improvements feasible suggestions have been made; whether they are put into action will show how capable the EU is of reform and where its priorities lie.

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## Zusammenfassung

### Von der Assoziierung zur Mitgliedschaft:

#### Was kann die EU dazu beitragen, die Osterweiterung zu erleichtern?

*Seit dem Beginn der Transformation haben zehn mittel- und osteuropäische Staaten Assoziationsabkommen mit der EU ausgehandelt und die Mitgliedschaft in der EU beantragt. Dieser Artikel behandelt die verschiedenen Möglichkeiten der EU, den Bewerbern beim Erreichen dieses Ziels zu helfen. Die technische Hilfe findet heute die größte Aufmerksamkeit; die finanzielle Hilfe könnte dagegen großzügiger bemessen sein. Der entscheidende Prüfstein zur Beurteilung der Bereitschaft der EU, sich zu erweitern, ist aber nicht ihre Politik gegenüber den mittel- und osteuropäischen Ländern, sondern ihre Entschlossenheit zu internen Reformen. Der Aufsatz skizziert Berechnungen zu den Kosten eines Beitritts der fünf CEFTA-Staaten mit und ohne vorherige EU-Reformen. Umsetzbare Reformen werden vorgeschlagen, die auch ohne Erweiterung dringend zu empfehlen sind, in einer erweiterten Union aber noch drängender werden. Da der anvisierte Beitrittstermin, das Jahr 2000, wohl nicht eingehalten werden kann und Übergangsfristen oder Teilmitgliedschaften nur begrenzt Lösungen bieten, kommt es für die EU darauf an, durch solche Reformen — und stärkere finanzielle Hilfen — der Erweiterungsperspektive Glaubwürdigkeit zu verleihen.*