Costs and Benefits of the EU Enlargement: The Impact on the EU and SEE Countries

Nuroğlu, Elif and Kurtagic, Haris

Türkish-German University, İstanbul University

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Elif Nuroglu
Assist. Prof. Dr.
Faculty of Business and Administration,
International University of Sarajevo
Hrasnička cesta 15, 71000 Sarajevo, Bosnia and Herzegovina
Tel: +38733957407 - Fax: +38733957105
E-mail: enuroglu@ius.edu.ba

Haris Kurtagić
Economist at Barmahala, Rozaje
Street Sarajevska n/a, Rozaje, Montenegro
Tel: +38263222060
Fax: +38251275002
E-mail: kurtagic.h@hotmail.com

Abstract: *The South-eastern enlargement of the European Union will be the sixth enlargement since establishing the European Community in 1957. This research uses the Gravity model to analyze the factors that have an influence on trade flows between the EU and South- East European Countries. The Gravity model explains patterns of trade with GDP, geographical distance and several dummy variables. Using the data from 2010, the gravity model analyzes trade flows between 23 countries from both the EU and South-eastern European Countries. Taking into consideration the costs of enlargement, this paper examines the possible effects of enlargement on trade flows, and its impact on the development of SEEC's. Moreover, it offers a solution for the South-east European countries which is the creation of the Balkan Union.*

Keywords: *EU-Enlargement, Gravity model, South-eastern Europe, European Union, trade flows.*

JEL Codes: F14, F15

Introduction

The South-eastern enlargement of the European Union (EU) – the sixth since 1973 – is a huge test for the EU, as well as for the applicant countries. The European Union consists of 27 members. Besides incumbent members, there are candidates and potential candidates. The enlargement with candidates and potential candidates is going to increase the EU area by 25%, the number of population by 19%, and absolute GDP by 5%. Although the exact time of accession is not clear yet, the European Commission is planning to start with a group of 3 states that are Croatia, Montenegro and Iceland. The applicants from South-eastern Europe are relatively poor countries with a GDP per capita below the EU average. The average GDP per capita of nine countries is \$10,490 that would be 3 times lower compared to EU-27 or 4 times lower compared to EU-15.

Similar to the third EU enlargement, the next enlargement would be a new challenge for the EU countries, as the integration of poor with rich countries increases heterogeneity. The South-east European countries will enter the EU on the basis of the Treaty of Accession. Once they access the EU, the members will be part of a union and a single market. A union of 27 countries with over 501 million consumers which have access to a single market is of huge importance. Construction of a single market of the European Union has brought the new impact, and improved the emergence of a common EU policy such as competition policy. The EU constantly works on the improvement of common policies, especially on a common market. Those policies have gained great importance since they strengthen mutual trade, improve the quality of products and services, and also expand the market, and most importantly they reduce trade barriers and increase positive effects of the common market. As a result, EU policies preserve the good functioning of the market, and the European Commission prevents or corrects the non-competitive behaviour of companies. In South-east European countries consumers enjoy a freedom of choice that is characterized by almost the same prices, lower quality and fewer innovations compared to the EU standards. The competition is present between South-east European Countries (SEEC's), but they are not competitive to the EU single market. These countries cannot achieve scale of economies or competitive advantages as the EU countries do. This research aims to discuss economic costs and benefits of the EU enlargement to SEEC's. The objective of this study is to show gains from trade for both sides, the European Union and SEEC`s.

From Maastricht Treaty to the Single Market and Single Currency

In order to improve trade among them, six countries (Belgium, France, Germany, Italy, Luxembourg and the Netherlands) have adopted first four regulations for a common market in agriculture, finance and regulation of governing competition. On 1 January 1973, Denmark, Ireland and the United Kingdom joined the EU. The first Balkan country, Greece, became the 10th member of the EU in 1981. The situation was stable until Berlin Wall fell in 1989, after which the European Economic Community (EEC) member states were negotiating over a new treaty in Maastricht in December 1991. The collapse of communism throughout Central and Eastern Europe has connected Europeans. As a result, in 1993, the idea of a Single Market was completed with free movement of goods, services, people and money.

Europe's single currency, the Euro, replaced the old currencies on 1 January 2002, when 12 EU Member States adopted it as their official currency, creating the euro zone. The euro zone aimed to make life easier for businesses, consumers and travellers.

On 1 May 2004, 10 countries became members of the EU: the Czech Republic, Cyprus, Hungary, Malta, Poland, Slovakia, Estonia, Latvia, Lithuania and Slovenia, while Bulgaria and Romania were accepted into the EU on 1 January 2007. Today, the EU has 27 member states. Enlargement to 27 was one of the most important steps in the history of European integration. 12 new countries in the EU, not only expanded geographical size and population, but also ended splitting the continent into two parts which was the case since 1945. As the idea of the EU says, democratic freedom has been settled in 12 new member states. The creation of the single market gave the European countries a strong incentive to liberalize previously protected monopolistic markets. Member states have removed all tariffs on trade within the union, while having unified tariffs on imports from outside the EU. It means that no matter which country is the importer, the tariff paid on products is the same, and once customs procedures are completed, goods can be shipped throughout the EU without additional duties. In accordance with the rules and regulations of the European Union, members of the union should also guarantee:

- Price stability,
- Stability of currency,
- Limitations of public debt, 60% of GDP,
- Economic balance with limited deficit of national budget,
- Investment stability, measured with long-run interest rates, and
- Budget deficit which is not higher than 3% of GDP each year.

In Tupy (2003), the benefits of free movement of goods are seen as major benefits for consumers in the EU. In general, the European Union has integrated the market, and established common rules. Those rules are implemented through technical standards of consumer protection, environmental standards, competition policy, and fairness in the workplace (Tupy, 2003). Thus, for the SEEC's the common market could be a place for integration of every aspect of the state. Once the borders are opened to free flows of goods and capital, people would look at historic events less, and they will go for personal interest.

European Union Today

Today, European Union exists as a union that aims to improve economic and political circumstances to deliver peace, stability, and prosperity, to help to improve living standards, and to promote a single currency that will build a single market, where people, goods, services and capital could move freely. It is not a government or state or international organization, but a novel entity which respects human rights. Many countries, a huge single market, and a single currency provide many benefits, but for whom? As a single market, the EU is a major world trading power which aims to put barriers down and simplify the rules to enable everyone in the EU to take advantage of the opportunities given to them by having access to 27 countries and 501 million people. Looking from economics perspective, small countries from Europe cannot achieve growth and prosperity without the EU. Therefore, in order to compete on the world stage and achieve economies of scale, the European countries need a broader base, and the European single market provides it.

The single market is one of the greatest achievements of the EU. Besides, restrictions on trade and competition between member countries have gradually been eliminated. All border controls on goods have been removed within the EU, together with customs controls on people. Tax barriers have also been reduced by partially aligning national Value Added Tax rates, which must be agreed by the EU member states. There is also EU's competition policy that attempts to ensure that within the European single market competition is not only free but also fair. Therefore, in the EU single market there is no cartel or unfair monopoly.

The European Union was created to succeed in political objectives, through achieving economic cooperation. In modern terms, people call it as an "area of freedom, security and justice", where every citizen has an equal justice and protection by the law. The European Commission represents the EU in international negotiations at the World Trade Organization (WTO). Right now, the EU would like to put more emphasis on quality of food, precautionary principle ("better safe than sorry") and animal welfare.

The EU has regional policy stating that European Funds should be used to improve development in regions that lag behind, to increase standards of living in these areas, to help young people and the long-term unemployed find work. European Funds are also distributed to farming and to less-favoured rural areas.

European Enlargement

Every new enlargement of the European Union is seen as a historic step toward long-term objectives of the union. Any country that respects liberty, democracy, human rights and fundamental freedoms, and the rule of law is qualified to apply for EU membership. Applying for EU membership is the start of a long and rigorous process. Once a country submits an application to the Council of the EU, it activates a sequence of EU procedures that may, or may not, result in the country being invited to become a member. After applying for membership, the process starts with accomplishing the Copenhagen Criteria. There are not many criteria, but, in essence, every country has to work on it, since the criteria are detailed. (Fontaine, 2010) mentions these criteria as follows:

- Institutions that provide high democracy, the rule of law, human rights and respect for and protection of minorities.
- Strong market economy and the ability to cope with threats and pressure within the union.
- Ability to take on the obligations of membership, accomplishing the aims of the union.

Once the Council unanimously agrees to begin with accession negotiations, discussions may be formally opened. The negotiation has got 35 separate policy areas that are called "chapters", and each candidate country proceeds separately from one stage of the process to the next. Thank to this process, the prospect of accession acts as a powerful incentive for reforms, providing simultaneous benefits to the EU and to its acceding members. Once negotiations are concluded to the desired level for both sides, a comprehensive Draft Accession Treaty is submitted for approval by the Council of the EU, the European Commission, and the European Parliament. After being approved, the treaty is signed by the candidate country and the representatives of all EU Member States. Afterward, all Member States and the candidate get the treaty for ratification. Once the ratification process is done, the treaty enters into force on its scheduled date, and the candidate country becomes an EU Member State.

Enlargement of the EU with South-eastern European Countries

The next enlargement in the EU is related to Western Balkan region. The structure and procedures to be applied on the Western Balkan region are the same as it was for the former candidates. A first significant step in this process is the establishment of European partnership with Albania, Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia. It would be a very important factor that assists Western Balkan states in preparing for membership within a rational framework and in developing action plans with timetables of reforms.

The European Union created an instrument for Balkan integration which is called the Stabilization and Association Process (SAP), launched in 2000. It was established as a long process for the development of Western Balkans both in terms of political effort and financial and human resources (Montanari, 2005). The aim of the SAP is to create conditions that closely resemble the EU. It enables candidates to prepare for future EU standards.

In the case of SEEC's enlargement, conflicts can arise between European Union members as a result of its redistribution effects. EU members observe SEEC's as a geographical area for expanding their market to export more goods and services. Once the union is enlarged, there will be new redistribution of income which might create lower income for some of the EU-27 countries. It is not the only threat for EU-27, high unemployment is another one. The neighbouring countries of the SEEC's might be affected more, when immigration from SEEC`s to the EU starts. First targets will be most probably Slovenia and Hungary as they are very close to SEEC`s.

When we observe previous five enlargements of the EU whether they were Pareto efficient for all members and candidates, the evidence suggests that enlargements were not Pareto efficient in every round (Schneider, 2007). Thus, as Schneider (2007) states, the next enlargement is going to be very complicated from redistribution and free movement of labour aspects. It is expected that South-eastern enlargement will affect labour-intensive and low-tech sectors in the EU member countries negatively but it will stimulate growth in skill-intensive, some capital-intensive and high-tech industries in Western Europe (Schneider, 2007). As a result, the candidate countries would have an incentive to export workers, rather than to attract them. Table 1 shows unemployment rate, population and GDP per capita for SEEC's in 2010.

Table 1: Basic Socioeconomic Indicators for selected South-east European Countries (2010)

	Population (millions)	Per capita GDP (current US$)	Unemployment rate 2009 (percent of labour force)
Albania	3.20	3,678	-
Bosnia and Herzegovina	3.76	4,409	-
Bulgaria	7.54	6,325	6.8
Croatia	4.42	13,754	9.1
Kosovo	1.82	3,059	45.4
Macedonia	2.06	4,460	32.2
Montenegro	0.63	6,510	19.1
Romania	21.44	7,538	6.9
Serbia	7.29	5,269	16.6

Sources: World Bank, *World Development Indicators.*
Monstat, *Department of statistics of labour market, life conditions, social services and household consumption.*

Table 1 shows that for some countries the unemployment rate is very high. Kosovo has unemployment rate of 45.4%, but the real unemployment rate is around 25% due to gray economics. The other countries have acceptable unemployment rates, but it is still considered to be high and a threat for the EU countries since it will create high labour inflows into the EU. Two biggest countries of the SEEC's became the EU members, and remaining 7 will bring 23 million new customers to the single market. When we take GDP's of SEEC's into account, then it is obvious that these countries have relatively low GDP`s, compared to the EU-15 (4 times lower), and EU-27 (3 times lower). Some candidate countries are economically weak, with high unemployment rate and low wages, and they will be ready to take advantages of free movement of labour immediately. However, the Union could apply some limitations on the free movement of workers from new members. There was a case when the United Kingdom joined the EU in 1973. The UK had to obey limitations on the free movement of its workers within Belgium, France, Germany, and Luxembourg (Schneider, 2007). This clause could be used when accepting SEEC’s to the Union, where Austria, Slovenia, and Hungary might ask for limitations of free movements of these three countries’ workers in order to sign accession treaty.

Table 2 shows trade flows between EU-15 (including Bulgaria and Romania) and SEEC`s in 2010. It is seen from the table that Croatia is a main trade partner of the EU-15 (BG+RO). 32.42% of imports from SEEC`s to the EU-15 (BG+RO) comes from Croatia. Moreover, Croatia is also the leader in exports to the EU with 39.32% of all exports from SEEC`s. Therefore, it is not surprising that Croatia is the first to enter the union when trade relations are considered. After enlargement the imports are expected to be higher for each SEE country.

Table 2: EU-15 (Bulgaria and Romania included) trade with SEE by country (2010)

	EU-15+BG and RO Imports		EU-15+BG and RO Exports	
	Million US$	Percentage of Imports	Million US$	Percentage of Exports
Croatia	4,149	32.42	9,069	39.32
Serbia	3,867	30.22	6,414	27.81
Macedonia	1,738	13.59	2,081	9.03
Bosnia and Herzegovina	1,732	13.53	2,557	11.09
Albania	1,157	9.04	2,442	10.59
Montenegro	152	1.19	500	2.17

Source: IMF, *Direction of Trade Statistics.*

Strategy of the EU

The strategy of the EU for creating sustainable growth and jobs encourages innovation within businesses and investment in people that might create a knowledge-based society. The idea is to attract more people into employment, and keep them in work longer as life expectancy rises. Besides, the ability of workers and enterprises to adapt to new challenges, providing better education and skills, effects of globalization and increasing mobility would increase the well-being of each society. By 2020, the EU aims to have accomplished the following targets:

- 75 % of the population aged 20-64 should be employed,
- 3 % of the EU's GDP should be invested in R&D,
- The "20/20/20" targets in terms of reduction of greenhouse gas emissions, renewable energy production, and energy efficiency should be met,
- The share of school dropouts should be under 10% and at least 40 % of the population between the ages of 30 and 34 should have a degree of diploma,
- 20 million fewer people should be living below the poverty line (Delegation of the European Union to the United States of America, 2011).

In order to accomplish these objectives, the EU adopted a proposal to re-focus on R&D and innovation policy on major challenges which are to enhance the quality and attractiveness of Europe's higher education system, to deliver sustainable economic and social benefits from a Digital Single Market, to enable the EU's industrial base to enhance competitiveness, to promote entrepreneurship and develop new skills for workers, and to ensure economic, social and territorial cohesion by helping the poor and socially excluded.

Costs and Benefits of the South- East European Enlargement

The Overall Economic Impact of the Enlargement

The countries of the last EU enlargement were highly welcomed in the EU alliance because they belong to those of the developed countries in Europe; and, hence, did not only cost nothing, but also contributed to the EU budget with significant amounts. In the case of South-east European enlargement, the EU incumbents are firstly concerned about the costs, rather than possible benefits. Typically, this enlargement would enable consumers and companies to arrange their businesses more efficiently to produce more output and higher income. When we take the costs of enlargement into consideration, the question is how the distribution of gains will be shared among the EU members. It is obvious that the countries with strong trade relations with the SEEC's will benefit.

The European enlargement is by no means a win-win project, but it is relatively unpredictable which has a tendency to create both winners and losers. Due to the huge wage-gap between East and West sides of Europe, there might be a migration wave from the East to the West as a result of full involvement of eastern side of Europe into the single market. On the other hand, there are almost certain gains for some new members. Therefore, the incumbent members prolong the acceptance of those candidates. One obvious case is Turkey.

When it comes to patterns of trade in the last few years, we see that the largest trading partner of the SEEC's is Italy, which absorbs 34 % of all exports from SEEC`s (Montanari, 2005), suggesting that geographical distance plays a considerable role in determining trade patterns which is the main reason why SEEC's trade mostly with their neighbouring partners. Table 3 indicates the value and percentage of import flows into the EU countries from SEEC`s and it supports Montanari (2005) by showing that the major trade partners importing from the SEEC`s are Italy, Germany, Austria and Greece. Table 4 shows almost the same results as Table 3. Italy, with 26%, is the leader in exports among EU-15 countries from SEEC`s, where Germany, Austria, Bulgaria and Greece come after. Both tables indicate the importance of distance in determining international trade flows and shaping trade relations. Countries that are away from the SEEC's receive only 10% of total exports from SEEC`s.

Table 3: EU-15 (BG+RO) Countries` Imports from SEEC`s (2010)

Country	Million US$	Percentage of total EU imports from SEEC's
Italy	4,426	34.61
Germany	3,047	23.83
Austria	1,680	13.14
Greece	744	5.82
Romania	488	3.82
Spain	411	3.21
France	396	3.10
Netherlands	378	2.96
United Kingdom	344	2.69
Bulgaria	338	2.64
Belgium	267	2.09
Sweden	106	0.83
Denmark	60	0.47
Portugal	41	0.32
Finland	27	0.21
Ireland	23	0.18
Luxembourg	11	0.09
Total	12,787	

Source: IMF, *Direction of Trade Statistics.*

Table 4: EU-15 (BG+RO) Countries' Exports to SEEC`s (2010)

Country	Million US$	Percentage of total EU exports to SEEC's
Italy	6,116	26.52
Germany	5,428	23.54
Austria	2,775	12.03
Bulgaria	1389	6.02
Greece	1,344	5.83
Netherlands	1,332	5.78
Romania	1,120	4.86
France	904	3.92
United Kingdom	785	3.40
Belgium	568	2.46
Spain	548	2.38
Denmark	254	1.10
Sweden	191	0.83
Ireland	149	0.65
Finland	109	0.47
Portugal	32	0.14
Luxembourg	15	0.07
Total	23,059	

Source: IMF, *Direction of Trade Statistics.*

Costs of Enlargement

The main costs of enlargement are the costs for public finances, the costs of labour market disruption, and the costs of wage competition (Grabbe, 2001). On the other hand, costs of expansion should be considered as well, meaning that the EU bureaucratic machinery is likely to grow to be unmanageable. There is also cost of preparing translations of all EU documents into the language of member states. However, the cost of translation is not so important when it is compared to the cost of reaching a consensus and making decisions in the EU.

Reaching a consensus on a unanimous or qualified-majority basis is likely to become more difficult (Baldwin, 1997). South-eastern countries have problems in reaching decisions in their parliaments, and accession to the EU would make things worse, since the new members would, very often, go for personal interest, rather than for the well-being of the society. Voting prolong, and not reaching decisions on time would increase the costs of bringing people to the parliament, and most importantly time spent while new regulations could have already taken place.

Nowadays, Croatia`s accession to the European Union is an important event for the neighbouring countries. Many analysts of macroeconomic issues warn saying that if Croatia enters the EU many mechanisms will change, especially for Bosnia and Herzegovina and its exports and imports, because the EU asks for high criteria of product quality. As a country with cheap labour, Bosnia is going to be a place where Croatia produces licensed products that are expensive to be produced in the EU. Croatian media talks also about negative consequences of accession to the EU as well. If Croatia joins the Union, it would become a small, politically and economically unessential province among giant European countries (R.I., 2012). The European Union is not a single country, but a union of different people and countries (big and small), where members represent their own interests on the European level better and more efficiently, than in a case they would, in today's globalized world, without the Union.

Economic Benefits of Enlargement

After enlargement, benefits will accumulate, not only to the members of the Union, but also to individual citizens. One of the principles on which the EU is based is that it will improve the welfare of its member states and their citizens. This process does not have appeal to the government of the member states which have initiated the accession process; it is also expected to have an influence on the citizens and their willingness to assist integration process. The main economic benefits after enlargement are the classical ones generated by integration processes from expansion of the Single Market like strengthening the Union's position in global markets and catching up with EU living standards. When SEEC's join the Union they will be passing from a free trade area for manufactured goods to a single market. The major benefit is free movement of workers, which is a highly sensitive issue.

Enlargement will be good for the European economy by adding over one million consumers to the single market that will create many new jobs in both the applicant countries and the incumbent member states. European companies are looking forward to seeing more states in the EU market that would possibly reduce the risk of doing business in the other half of the continent.

In the long-run, the applicant countries need help from the EU in order to increase private investment to meet EU`s environmental and transport standards. The main economic benefit of EU membership is the potential improvement in investment climate of the South-east European countries. When the SEEC's join the EU, participation in the single market should involve the end of contingent protection (anti-dumping and safeguards). In1999, the total number of anti-dumping investigations opened was 86 (Nello, 2002). It is obvious that some countries will be better-off and some worse-off. Bosnia and Herzegovina can increase the sale of its domestic tobacco company`s products if it proves that the Croatian tobacco company is dumping in Bosnia which was speculated in media in 2010.

The EU imposes environmental regulations regarding environmental quality protection, production processes, and products (Tupy, 2003). One of the significant benefits will be the increase in the quality of products in SEEC`s. It will affect local producers, and decrease their profits, but more importantly, the customers will be better-off. Besides, citizens will enjoy higher air quality, water protection, pollution controls, and get rid of some other things that create negative externality. For instance, people from Zenica (Bosnia and Herzegovina) could have better air quality, when Environmental Regulation Agency introduces pollution control on Metal Company.

Gravity Model

Gravity Model of Exports from EU-15 (including Bulgaria and Romania) to SEEC's

In this part, trade flows between the EU and SEEC's will be analyzed using one of the most popular models in International Economics – Gravity model. It is aimed to evaluate whether there could be a potential for trade growth between two groups of countries. The answer to this question can be obtained by estimating a gravity model of trade. The model that is used in this research is very similar to the one that Montanari (2005) uses while explaining trade patterns. Gravity model describes bilateral trade patterns in accordance with socioeconomic and geographical characteristics of the countries in the sample (Montanari, 2005).

The countries included in the analysis are divided into two groups. First group consists of the EU-15, while the other includes countries from the South-eastern Europe. Even if Bulgaria and Romania are from the South-east Europe, the research uses them as the EU members, to obtain more precise results. EU-15 does not include Bulgaria and Romania, but EU-27 does, so we obtain a real potential of the SEEC's only if we include two countries into the first group. Greece has been part of the EU-15 for a long time; therefore, it will be included in the first group.

This study uses the data from 2010. Thus, there are separate indicators for Montenegro and Serbia. Due to the lack of data, the analysis excludes Kosovo.

Thegravity equation used to estimate trade flows is as follows:

$$lnX_{EU-SEEC} = c + lngdp_{exp} + lngdp_{imp} + lndist + BOR + CU + \varepsilon_{EU-SEEC} \quad (1)$$

where

$X_{EU-SEEC}$: is export flows from EU-15 countries (including Bulgaria and Romania) to SEEC's measured in current US Dollars in millions,

gdp_{exp}: represents the GDP of the exporting country expressed in current US Dollars in millions,

gdp_{imp}: is the GDP of the importer country expressed in current US Dollars in millions,

$dist$: is the distance between capitals of exporter and importer measured in kilometres,

BOR: is the dummy variable which is 1 if exporter and importer share a common border and 0 otherwise,

CU: is the dummy variable which is 1 if exporter and importer countries use a common currency and 0 otherwise, and

$\varepsilon_{EU-SEEC}$: describes the error term.

Data sources are explained in the Appendix. The gravity model says that if countries share the same border, and/or use the same currency they should trade more. In the case of signing a bilateral agreement, like Central European Free Trade Agreement CEFTA, trade barriers decrease and countries trade more.

The Basic Gravity Model

Table 5, which consists of the results given by four different models, explains patterns of trade between the EU countries and SEEC's. In Model 1, GDP of exporter country seems to have a positive effect on trade flows and its coefficient of 1.06 shows that when GDP of exporting country increases by 1%, its exports increase by 1.06%. Similar result is given for the importer country`s GDP, where the coefficient of 0.78 shows the percentage increase in trade flows when GDP of importer increases by 1%. There is a negative coefficient for the distance indicating that when countries are further they trade less. In order to save the costs of transportation, countries trade mostly with their neighbours and the model says that 1% increase in distance will decrease trade by 2.39%. Besides that, the model uses dummies such as common borders and currency. While common borders have a positive impact on trade flows with a coefficient of 0.53, the common currency seems to have a negative effect with -0.62%. This negative coefficient might be the result of not using Euro. Montenegro is the only member of the Euro zone among SEEC`s which uses Euro. The value of R^2 of 86% shows that this model explains 86% of the variation in trade flows between the EU and SEEC's in 2010.

Table 5: Gravity Model Regression Results. Dependent Variable: Log of Exports

Variable	Model 1	Model 2	Model 3	Model 4
Exporter GDP	1.06	1.06	1.06	1.06
	(-0.07)	(-0.07)	(-0.07)	(-0.07)
Importer GDP	0.78	0.78	0.89	0.76
	(-0.11)	(-0.11)	(-0.09)	(-0.11)
Distance	-2.39	-2.34	-2.52	-2.33
	(-0.18)	(-0.2)	(-0.17)	(-0.2)
Common Border	0.53	0.58		0.58
	(-0.35)	(-0.36)		(-0.36)
Common Currency	-0.62	-0.64		-0.74
	(-0.3)	(-0.3)		(-0.33)
Constant	-11.3	-11.72	-13.08	-11.54
	(-3.28)	(-3.35)	(-3.07)	(-3.36)
R^2	0.86	0.86	0.85	0.86
RMSE	0.81	0.81	0.84	0.81
AIC	249.31	250.81	255.99	252.13
BIC	265	269.11	271.68	273.05
Number of observations	101	101	101	101

Source: Author's calculations

Numbers in parenthesis are standard errors

Bilateral Effects Model

The equation used to estimate Model 2 in Table 5 is:

$$lnX_{EU-SEEC} = c + lngdp_{exp} + lngdp_{imp} + lndist + BOR + CUR + bilateral + \varepsilon_{EU-SEEC} \quad (2)$$

where $bilateral$ is a dummy variable which takes 1 for a specific importer and exporter country pair and is used to capture the effects of any political, historical or cultural event between two countries on their trade flows. All other variables are the same as Equation 1.

Model 2 has exactly similar coefficients of GDP as the first model. Thus, if there is any increase in GDP of exporter and importer countries, the trade will be boosted. The coefficient of common borders says that trade increases if two countries share a common border.

Main Effects Model (Exporter and Importer Fixed Effects)

The equation used to estimate Model 3 in Table 5 is:

$$lnX_{EU-SEEC} = c + lngdp_{exp} + lngdp_{imp} + lndist + expfix + impfix + \varepsilon_{EU-SEEC} \quad (3)$$

where $expfix$ equals 1 whenever a country is exporting and 0 otherwise, and $impfix$ equals 1 whenever a country is importing and 0 otherwise. These dummies might differ depending on the countries' tendency to export and import.

This model does not include dummies and bilateral effects variable, but only counts on exporter and importer fixed effects. In general, the model does not give a better picture; R^2 is slightly lower than the first and second model, and Akaike`s information criteria (AIC) is also higher.

Main Effects Model with Dummies

When we enlarge Model 3 with common border and common currency dummies, the model becomes the following:

$$lnX_{EU-SEEC} = c + lngdp_{exp} + lngdp_{imp} + lndist + BOR + CUR + expfix + impfix + \varepsilon_{EU-SEEC} \quad (4)$$

This model has a higher R-squared than Model 3, which is 86%. The distance has a negative coefficient as usual confirming that neighbouring countries trade more with each other than other countries.

The results of our several models show that trade increases with economic size of the countries while it decreases with distance between them. The gravity model could be useful for analyzing international trade flows and can be used to test the impact of new policy arrangements in SEE countries.

Results

Measuring overall economic impact of EU-enlargement is very difficult task given that there are problems of global economy, uncertainties which could influence the whole process. The economic benefits to the EU-27 may not be obvious in the short-run, neither the costs. However, in the long-run the whole European economy is expected to gain from enlargement.

Table 5 represents four different models consisting of various variables. Taking part in the single mar ket would lead to an increase in the outputs, and therefore imports and exports will be higher which in turn leads to an increase in GDP. According to the results of our models, if SEEC's access the union, GDP's will become higher, trade flows will increase, and at the end export flows will be larger. Therefore, households would benefit from the European enlargement and from the removal of tariffs which leads to the reduction in import prices, and will affect the allocation of household income positively. The removal of trade barriers would have a clear impact on price setting as well. The scenario would be a reduction in prices. Conversely, the increased demand should also be taken into account, together with the removal of tariffs, which at the end will provide a positive impact.

The European Union has to manage enlargement appropriately if it wants to gather all the potential benefits. Flourishing management depends on developing a strategy in favour of enlargement producing gains for the public and for interest groups.

When we compare previous enlargements with the next ones, we see significant differences. For instance, Greece, Portugal and Spain became members of the EU before the single market and monetary union programs were implemented. Thus, they became members when the EU was much less integrated and smaller. Today, the EU economy is well-experienced and it has a faster growth rate in trade than it was in time of accession period of Portugal and Spain.

The main benefits of enlargement for the SEEC's are not only economic, but they are also expected to provide stability and security in the region. Major risks are large migration flows, wage competition, and the costs to the EU budget. Our results show that there is a room for trade to increase, especially, in neighbouring countries. SEEC's would have to invest in new technologies to be competitive for the EU market.

Policy Suggestions

Yugoslavia was located in the South-eastern Europe, in the heart of the Balkan Peninsula. It connected two continents, Europe with Asia, and was the gate to the Black Sea. The country had resources and good geographical position to grow and become super power of Europe. Unfortunately, the country could not run resources properly.

Yugoslavian economy was oriented toward agriculture, so the whole national prosperity depended on the development of agriculture. The characteristic of Yugoslavia is seen in the fact that out of 24,849,425 hectares of the whole territory, 11,500,000 hectares, or 46 per cent, was devoted to agriculture (Roucek, 1933). The country produced hemp, cotton, hops, opium, tobacco and so on. All these, and many other products, were high quality. The important thing is that no single part of Yugoslavia produced all these products. The country consisted of 7 parts that are today independent countries (Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Montenegro, Slovenia, and Serbia). Hence, each part of Yugoslavia was famous for the production of a particular good. Exports went mainly to France, Germany, and Switzerland. Moreover, each province of Yugoslavia has its own special kinds of fruits. Different fruits and variety of foods and beverages were produced in a way that is traditional for every region of the country. Besides that, there were plenty of mineral resources such as coal, iron, copper, etc. Yugoslavia could, by its richness of iron, take a place as one of the leading countries in Europe. The main importers of Yugoslavian products were Italy (28.31%), Austria (17.68%), Germany (11.66%), Hungary (7.18 per cent), Greece (6.05%), etc. The main products for exports were wood, cement, cereals, and ores (Roucek, 1933).

It seems that today, the former parts of Yugoslavia need a stabilization process that would help them reach the previous conditions. It is obvious that countries need capital and investment in infrastructure.

Taking all of these facts into consideration, a solution for the SEEC's, besides the European Union, might be the creation of the Balkan Union consisting of 7 countries which are Albania, Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Montenegro, and Serbia. The Balkan Union would look like the European Union. There would be institutions to regulate the union, mainly from culture, education, and trade aspects. The target should be that each member specializes in the production of particular goods and services, and achieves comparative advantage with economies of scale. Developing countries, as "members" of the Balkan Union, must diversify their production structure and strengthen domestic demand. People should buy domestic products more, and stop buying similar foreign products, thinking foreign is better.

In today`s world, countries do not depend only on agriculture and manufacturing, but also on tourism. Thus, economic policy for each country should be set to take advantages of potentials they possess. There are countries such as Bosnia and Herzegovina and Montenegro that need to be oriented towards winter and summer tourism.

Conclusion

This study discusses economic costs and benefits of South-eastern enlargement of the European Union. The purpose of the EU is to maintain a peaceful and prosperous life throughout Europe. At the beginning of the fifties in the last century, the EU has signed many treaties and brought new policies that would ensure a zone for free capital movement. Besides that, the Union had five enlargements and introduced a common currency. Creation of a single market, which today consists of 501 million of consumers, is to provide a better life for every citizen.

Next enlargement is of the South-east European countries. After accession of the SEEC's, the European Union will have more than 30 members with diverse cultures, histories and languages. Can such a diverse union of nations create a common political "union"? The EU was a trial to unify Europe, but it is obvious that it is difficult, since it is impossible to connect Germany or Sweden with, let us say, Mediterranean, and there is no surprise for the failure of Greece and Italy. Can citizens of the EU establish a sense of being European while deeply belonging to their country? In essence, they can, if incumbent members follow the example of the first European Community. The moral legitimacy of the European Community is based on compromise, while consolidating peace between former enemies. It stays within the principle that all members, large and small, have equivalent rights and respect to the minorities. Therefore, the next enlargement needs to bring equivalence to small countries, and more importantly, produce a stable market. EU member states account for almost 1/3 of the entire global economy, so in that sense the common market is a preferable means to the global market.

This research uses the gravity model to analyze trade relations between EU-15 (including Bulgaria and Romania) and SEEC's. After adding dummy variables such as common borders and common currency to the model, the results show that there is a space for growth of trade between two groups. Trade is positively affected by the GDP of exporter and importer countries. Larger GDP means higher production and increased ability to trade. However, distance has negative impact, and in our model it seems to shrink trade if a country is far away from its partner. On the other hand, common borders positively affect trade, so by diminishing trade barriers, quotas, and taxes countries could stimulate trade. Although the accession of SEEC`s into the EU might produce some negative effects, its trade effects will be clearly positive.

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Appendix

Data and Variables Used for the Estimation of the Gravity Model

The reporting countries that are used for the analysis are the members of the EU-15 (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and United Kingdom). Although Bulgaria and Romania are not included in the EU-15 they are attached to the first group but not in the

South-east European countries. There are six partner countries from SEE: Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, and Serbia.

GDP and population data are taken from the World Bank's World Development Indicators. GDP of exporter and importer countries are measured in current US Dollars in millions. Bilateral trade flows, the sum of imports and exports, are taken from the IMF's Direction of Trade Statistics.

Distances between capitals of the countries are taken from www.viamichelin.co.uk. The most used routes for transportation of goods by trucks and by ship (in case of Italy and its partner countries) are taken for analysis.

Dummy variable for border takes the value of 1 if the EU-15 country and its partner share a common border, and 0 otherwise.

Dummy variable for currency takes the value of 1 if the EU-15 country and its partner use a common currency, and 0 otherwise.