Costs and benefits of EU Ascension

Kirrane, Chris

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Chris Kirrane

Abstract

The subject of this paper is the investigation of the benefits and costs of membership from Eastern European countries to the European Union and the political constraints that result from this cost-benefit analysis. The main conclusion is that it is believed that accession will be beneficial for the enlarged Union as a whole, some countries will obviously benefit more than others. This will be partly because they will maximise the benefits of the EU budget better than others, but also because the economic benefits per se will not be distributed equally among all Member States as well as within the EU. The first part summarises the economic benefits of the accession process and is followed by a rapid identification of costs. The third part looks at the political economy aspects of implementation and highlights the problem areas.

There is little controversy among economists that the accession of Eastern European countries to the Union will be beneficial for the candidate countries. The same can probably be said of existing member countries, although the immediate economic benefits are much smaller. While this should, in principle, facilitate membership, the actual distribution and transfer of payments complicate the issue. Moreover, the calculation of profit and cost depends on a multitude of decision variables. It is therefore almost impossible to say for sure which country or group of countries will benefit the most from the reforms. And, moreover, the costs and benefits are strongly linked to the internal reforms of the EU. Reforms of decision-making mechanisms within the EU and agricultural policy will be of particular importance. It will be analysed, from a financial and political point of view, some of the technical problems and difficulties involved in the accession process. In addition, the exact meaning of accession for the candidate countries becomes more blurred, opening up new margins of negotiation. It is possible that in the areas of labour mobility and environmental gains the transition will be longer. As Berglof and Roland (2000) note: '... membership becomes more gradual and its meaning becomes more and more vague'.

Equally between all the Member States and within the different population groups. Some groups might lose out as a result of membership. Therefore, it is not surprising that some lobbies opposed membership. In the current context, the European Union cannot take the risk of ignoring these concerns if it does not want to lose the support of its citizens. As it is quite possible that it will be politically difficult to reduce the impact of membership on relative losers, through budget transfers, the EU and the acceding countries will likely opt for a more flexible membership. This will likely involve the implementation of long transition periods on issues such as labour mobility, environment and infrastructure and trade in agricultural products.

Therefore, as it is probably impossible to say how accession will actually be achieved, this paper tries to highlight the economic benefits and costs for both acceding and EU countries. This includes both the impact of accession on economies and the implications of enlargement for the EU budget. It is possible that the purely economic benefits are distributed unequally between countries and between their different groups. In fact, there may be some losers after accession despite the overall positive effects of this reform. These losers must be compensated in one way or another. Since the increase in budget transfers is not envisaged, it is possible that the alternatives will change the real meaning of membership. Such transition periods will change not only the distribution of cost and gains but also the overall effect. The impact on aggregate net economic benefit of these special terms could be negative or positive.

The paper is structured as follows. The following section summarises the economic benefits of the accession process followed by rapid cost identification. The third section looks at the economic and political aspects of implementation and highlights the problem areas. The last section concludes.

In the absence of conflicting facts (being a member and not being a member at the same time is impossible), the candidate countries must be treated as control groups despite the fact that they each have a unique history and it is therefore possible that their initial conditions differ from those of other countries that joined the Union, such as Spain. In addition, membership is a complex process and its effects on growth can be transmitted through different channels.

It seems, however, that membership in the Union itself does not necessarily have a significant impact on a country's development. In return, it gives countries an opportunity to move faster if accompanied by sound policies. It also appears that many of the benefits of joining the EU occur before the actual entry as countries need to implement reforms in order to be successful. Greece is a good example of this process. Becoming a member of the EC in 1986 did not seem to have a great impact on Greece. This has often been described as an opportunity lost by Greece (Baldwin et al, 1997), led by bad domestic policies with weak constraints imposed by Brussels. On the other hand, when the country wanted to be part of the European Monetary System (EMS) and the constraints imposed by Brussels became more effective, the Greek economy grew rapidly even before the actual date of integration. Similarly, there is good reason to believe that the prospect of joining the Union has played a vital role in the impressive performance of the economies of a large number of Central European countries in recent years.

Associated static effects are: - the development of trade: when the price of a good is lower in one country than in another, lowering the barrier will be beneficial to consumers of the second country because the price of the consumption of this good falls. The efficiency of the economy as a whole is increasing; - the change in the orientation of trade: when the reduction of border barriers leads to the purchase of goods from a supplier that was previously more expensive. Typically, lowering tariffs may lead EU countries to import from central European countries rather than from abroad, although net import tariffs outside Europe are cheaper.

In what follows some of the studies that have analysed the economic benefits of joining the Union will be summarised. These can be divided on the one hand into econometric studies using partial equilibrium models and trying to predict the impact of EU membership on trade and the flow of factors such as labour and capital, and studies using general equilibrium models that simulate the impact of membership. This section also shows why the result of growth following enlargement will take a different form in the candidate countries due to their initial condition compared to former relatively poor members such as Greece, Ireland, Spain and Portugal.

In general, the economic benefits of international integration stem from both a more efficient allocation, which traditional trade theory emphasizes, and the effects of dynamic allocation, which are mainly concerned with the theory of growth.

While the development of trade still has positive effects on overall welfare, the effect of the change in trade orientation may be ambiguous. If the lowering of barriers goes through lower tariffs, the effect is clearly negative. When, instead, it comes from the decline in commercial rents associated with the adoption of common standards or fewer border controls, the effect is really positive. As integration between the EU countries and the central European countries will mainly involve the latter, it is likely that the effect of the change in trade orientation will be positive.

Despite the overall positive effect of trade creation, there may still be member countries that lose out individually. This is why some Mediterranean countries express their concern that, although the effects of trade creation may be positive for the Union, they may also be harmful to them (Kirrane, 1999). The reason is that the benefits of cheaper consumption will mainly be felt in Northern Europe. Conversely, the main effect on Southern countries EU will be that their producers will have to compete with the central European countries in high-use industries.

Efficiency gains due to the allocation are a separate category. Their size depends to a large extent on the number of trade barriers that are being reduced. As tariffs applied to central European countries in trade with Western Europe are already low, it is unlikely that these effects will be significant. However, one will see in the next section that econometric studies show that there is still a place for the intensification of trade relations.

Nevertheless, it is likely that the most important membership outcomes come from cumulative effects, which add to a permanent base and are capable of influencing the long-term growth rate. These will come from increased competitive pressure, increased foreign direct investment (FDI), and technology transfers of know-how between countries, stimulated by more emigration. Lower risk premiums associated with EU accession will increase capital flows in the region, a finding that emerges from both econometric and calculable equilibrium models.

Buch et al. show that accession to the Union increases trade within the EU as a region, while reducing trade outside of the Union below the normal level. Using results from OECD countries, the authors use their estimates to simulate the effect of membership on trade between EU member countries and candidate countries. They find that, with the exception of Hungary, imports from the EU are still below those anticipated. Poland, Romania and the Czech Republic would receive, in total, only between 86 and 72% of anticipated imports. All other countries would receive shares of less than 67%. The same is true of exports. The acceding countries would export to the EU only a fraction of what would be expected.

According to standard economic theory, capital should flow from rich to poor countries. The amount and speed of these flows will depend heavily on the country's *ex ante* risk premium. It has been shown before that this risk premium will be reduced for central European countries once they enter the EU. The reasons can be various. The legal system is supposed to become more stable therefore, the amount of flows to Eastern Europe is expected to increase. Nevertheless, given the specific history of the acceding countries, this result is much less obvious. Many countries have been able, over the last decade, to attract substantial amounts of foreign capital during privatisation. It is likely that this flow will come relatively quickly to an end and its effect may outweigh the increase in capital flows generated by EU membership. Apart from the impact of EU accession on the size of capital flows, it is also possible that the structure of these flows may change. It is known (Razin et al, 1998, Bolton and Freixas, 2000) that a hierarchy in capital flows, a function of the magnitude of information asymmetry and differences in uncertainty about the under contracts across countries exists. In the case of relatively less developed countries, the most important type of capital flow is foreign direct investment (FDI), but bank lending is expected to replace it gradually as financial markets develop and expand as property rights become safer. Financial securities flows are only likely to catch up with them at later stages of development. As accession involves the upgrading and harmonisation of standards with those of the EU, this may have an effect on the composition of non-FDI capital flows. Buch and Piazzolo (2000) simulate the expected bank loans for the candidate countries and show that, even excluding the banking effect of the Union, bank loans are currently only 50% of their expected level. If the membership effect is included, the acceding countries receive only 20% of the international bank loans that could be granted to them. These ratios are much smaller than those resulting from trade regressions, suggesting that the impact of EU membership on bank lending will be much more pronounced than on trade relations.

The authors do a similar exercise for portfolio flows and again show the significant impact of EU participation . When they simulate portfolio flows in the acceding countries, they find that these portfolio flows are already reaching higher levels than their potential outside the Union. Nevertheless, while the accession effect to the EU is included, only Hungary still exceeds its potential, while in most other countries there is still a substantial margin for increasing portfolio flows. Thus, the Czech and Slovak Republics receive only about 60% of their potential, while the Baltic countries only arrive at levels of 10-30%.

In the light of the theory of the structure of capital flows, it should be noted that the acceding countries have exhausted a greater part of their potential for portfolio flows than for claims in the banking sector. This is most likely related to the history of privatisation, which has pushed equity markets further into development than expected for countries with such a high level of development. Simulations of the same type for FDI flows indicate that their level exceeds the levels expected for the most advanced countries. Nevertheless, in terms of stocks, it still seems possible to have room for manoeuvere, especially if the effect of being in the Union is included. Thus, the authors conclude that the Czech Republic, Hungary and Poland are close to their capital flows potential and that only a relatively minor effect could be expected from membership. For the other seven countries, there is still a significant margin of growth in capital flows.

Differences in per capita income between current EU members and the 10 central European countries are larger than in previous accession episodes. The wage differentials are comparable with those between the United States and Mexico. However, compared to NAFTA, the European Union is more than just a trade agreement because it allows the free movement of labour between its member states. Given the magnitude of the income differential, current and future members of the EU are concerned about the impact of membership on the labour market and its impact on distribution. While standard trade theory (Heckscher Ohlin) tells us that the removal of trade barriers or emigration will benefit all countries, it speaks much less about the distribution of these gains. The relative price of the rare factor in each country will decrease to equalise factor prices. The unions see the main threat as an influx of relatively unskilled workers to the West, which could generate lower wages.

However, so far the movement of labour has been very limited. The number of immigrants from the acceding countries in the EU has been estimated at around 850 000 while the number of employees is rather small, around 300 000. The majority of these immigrants live in Germany and in Austria (80%). However, the number does not include illegal immigration, which is quite substantial. Boeri and Bruecker, using data on emigration in Germany from 1967 to 1998, estimated potential emigration once labour markets were open. The most important factors influencing migration are wage differentials and unemployment rates between the host country and the country of origin. Assuming that the central European countries converge at a rate of 2% per year to reach EU levels, which is consistent with the experience of post-war Western Europe, and assuming that these unemployment rates keep the same values as they currently are, the authors estimate that the number of emigrants will increase from 0.85 million now to 3.9 million 30 years after the opening of the market. This represents approximately 4% of the current population of the acceding countries and only 1% of the population of the member countries of the Union (i.e. it is surely not enough to prevent the population of Western Europe from decreasing). In terms of flows, the authors estimate that emigration will initially reach 335,000 individuals in the first year, to decline exponentially as income disparities will be reduced. Compared with the emigration of Spain or Portugal when these countries joined, the authors highlight the fact that, unlike the Eastern countries, the emigration levels of the countries of the South had already reached their long-term balance before accession. While the impact of emigration flows is not significant for Europe as a whole, the same cannot be said for border regions.

As a result, Bruecker and Boeri estimate a fall in the wages of low-skilled workers in Western Europe. It is not obvious that, in theory, the loss that these workers will experience will be offset by transfers from global gains or a reduction in consumer prices. These effects could manifest, in principle, not only because of emigration but also through a growing reallocation of activities in the East, relatively important for low-skilled labour, or through more intense trade in these goods. Knowing that equalisation of wages in the tradable goods sectors can be achieved without mobility, and that this is probably what has happened in the last decade, it is the non-tradable goods sectors such as the building that will probably be the most affected.

Of the 335 000 individuals migrating in the first year, 220 000 are likely to go to Germany and 40 000 to Austria. The impact on wages is difficult to estimate because investment and income are likely to react to this flow as well. The microeconomic exercises (Boeri et al.) seem to suggest that a 1% increase in emigrants in one branch of industry reduces resident wages by only 0.25% in Austria and 0.6% in Germany. At the same time, the individual risk of dismissal increases by 0.8% in the Austrian sample and by 0.2% in the German sample. As the increase in the proportion of foreigners is expected to be gradual, the impact on wages may be small. Surprisingly, there seems to be no studies analysing the effect of accession in the candidate countries. However, we could anticipate upward pressure on wage levels, given that workers have the option of leaving abroad.

East Germany was the first of the former communist bloc to join the EU. In order to avoid large-scale emigration, the wage level in East Germany was increased immediately, with the devastating effects. It is unclear whether concerns about large-scale emigration were really true. Nevertheless, it is possible that there will be significant wage pressures in the candidate countries once the workforce becomes mobile. It is therefore paradoxical that countries such as Germany advocate for transition periods and not the candidate countries that have much more to lose. The costs of emigration between the acceding countries and Western Europe are surely higher than they were between East Germany and West Germany because of language barriers. However, there is already a skills shortage in some industries in Eastern Europe that resembles skill shortages in the West, such as in the computer and technology (IT) fields, and one could expect an increase in the wages of these groups. As a result, wage dispersion could very well increase in the candidate countries.

In the absence of adequate data to construct and estimate an econometric model of the global economy that could be used to predict all the effects of accumulations and allocations, Baldwin, François and Portes (1997) have suggested replacing it with simulations based on general equilibrium models. Once calibrated the model of global economy, the result of the simulation shows that all East European countries are winners following the accession to the EU including the current independent republics of the former USSR, although the impact is clearly greater for the acceding countries whose GDP will increase by 1.5% compared to the case where there is no accession. These results are to be compared with the gains of 0.2% in the current Union and 0.3% in the former USSR. In addition, exports from these countries are estimated to increase by 25%.

The model simulates the effect of accession by making the following assumptions about entry into the Union: elimination of all tariffs and quantitative restrictions on all trade within the European Union - central European countries, including agriculture; the adoption of the EU common external tariff (which is, in general, more liberal than that currently applied in the central European countries); single access to the economies of all member countries, which implies having security, standard technology, and the abolition of border controls; acceptance of the Common Agricultural Policy. Access to the Single Market is modeled as a reduction of real trade costs (and not tariffs) by 10% which translates directly into a gain as these resources are consumed rather than redistributed through tariffs.

Overall, the results are more or less comparable with those previously found by Brown et al. (1996), who also use a calibrated general equilibrium model. The gain for the countries of the former USSR is mainly due to the fact that the current external tariff of the acceding countries exceeds that of the EU as regards imports from the countries of the former USSR. In the second step, the authors add a channel through which membership can affect growth: the reduction in the risk premium that countries must pay to be perceived as relatively unstable compared to the country members of the EU. Stability is not only linked to the political dimension but also to the legal framework, which will be reworked and modeled on current EU legislation. In addition, membership brings countries back to EMS participation, leading to conditions that significantly reduce macroeconomic uncertainty.

The simulation shows that this 'risk premium effect' is greater than that related to the elimination of trade barriers, which is in line with the econometric studies presented above. They find that annual GDP will increase in the long run by almost 20% thanks to EU membership. This is due to an increase in the capital stock in the acceding countries, which is expected to increase by 65%. This effect seems enormous, but it should not be read as a gain of pure well-being. As Rodrick (1997) has shown, this estimate does not tell us anything about the cost of consumption initially planned to achieve this increase in the capital stock. The effect on the current EU member states remains almost unchanged from the expected scenario.

The authors try to spread the gains within the EU to the different member countries. They show that it is possible that the gains are not distributed equally, with Germany taking a third of the total (3.8 billion in 1992 prices), France 19.3% and the United Kingdom.1%. The unequal distribution of earnings is not only due to the different sizes of these countries but also to their different economic structures. The sectors most likely to be developed are sectors that serve to create intermediate goods (transport equipment and capital), which represents a substantial part of the German economy.

Piazzolo (1998) points out that the analysis of Baldwin et al. (1997) assumes that the acceding countries are on an equilibrium growth path. This would imply that some ratios, such as the capital-ratio output, are more or less constant, which contradicts both the evidence and the idea of the removal of the structural distortions imposed by the communist regime. Therefore, membership will not be a passage to a balanced growth path to another as supposed Baldwin et al. but it will instead generate convergence towards a different long-term equilibrium growth path. This will differentiate the effect of Union membership given that the current stock of current capital could be quite different from that generated by simulations that use structural parameters mostly derived from market economies.

Keuschnigg and Kohler estimated another calibrated general equilibrium model, emphasising the benefits for Austria. They take into account the emigration of labour and include a government budget. Interestingly, they show that the possible additional payments from Austria (or another Member State) to the Union's budget will be offset by the additional income tax collected as the result of the highest growth.

The current allocation of the central European countries to some extent determines the kind of growth they are likely to experience. In view of the use of different factors of production, it seems obvious that growth in the candidate countries will have to take a form quite different from that of the latest members of the Union, namely the countries of the South. In the acceding countries of southern Europe, part of this resulted in higher occupancy rates as a result of both a reduction in unemployment and a greater participation in the labour force. This type of extensive growth will be lower in the current candidate countries with few exceptions. The labour force, at 52% in these countries, is now higher than in countries such as Germany (50%) or France (45%), which is partly due to their specific history. Communist regimes have always encouraged women to work. In this respect, the labour force participation rate in the southern countries was low when they joined the EU, around 40%, and it has steadily increased since then, contributing to the GDP per capita. Similarly, unemployment in many acceding countries is not very high (with the exception of Poland), so that occupancy rates in the region are significantly higher than in most other member countries of the EU.

The communist regime has particularly emphasised the accumulation of large capital stocks. Despite the fact that most of them are now out of date, high investment rates in recent years should have brought capital stocks close to their equilibrium level in the long run.

In fact, gross domestic investment rates in the acceding countries have largely exceeded the levels recorded in the EU member countries. During most of the last decade, investment as a share of GDP, is around 26.5% in the acceding countries, both France, Germany and the most recent Union members have investment rates of about 21%. Assuming that the long-term investment rates are not too different between European countries, a large part of the capital renewal should have already occurred in the acceding countries. In fact, investment rates could soon start to fall in some of the acceding countries, similar to what happened with the last EU members, which had significantly higher investment rates. when they joined. It is difficult to estimate the time needed to reach a capital stock comparable to that of the current EU, given that neither the initial capital stock at the beginning of the transition nor the probably very high depreciation rate during the transition period. Nevertheless, if one considers the extreme assumption of a 100% capital stock depreciation during the first year, while new capital investments depreciate at 10% per annum, the current investment rate of the countries would only need 15 years to reach a steady-state capital stock compatible with the investment rate in the current EU member states (210%). Since it is unlikely that the entire initial capital stock will be depreciated, the actual duration needed is probably shorter. In any case, it is difficult to measure the contribution to the growth process in some of the candidate countries of the capital renewal itself.

In the acceding countries, the extensive dimension will bring a smaller contribution to growth compared to countries such as Portugal or Ireland. On the other hand, it is the intensive dimension that will have to take part in catching up. This will involve the more efficient use of existing resources, both in terms of human and physical capital, and the improvement of technologies through adoption processes. There is unfortunately little consensus among economists as to how to increase the rate of growth of factor productivity. However, the performance of a large number of acceding countries has been rather impressive in recent years. With the exception of the Czech Republic, which experienced a prolonged recession during this period, factor productivity growth in the acceding countries far outpaced that of the EU member countries.

Despite this impressive performance, labour productivity is still significantly lower in the acceding countries than in the member countries. This is particularly true for the industrial sector and, in some countries, for agriculture. While the industrial sector has, on average, reached 38% of the EU average, many tertiary sectors have reached productivity rates close to or even above 60% of the average level of labour productivity in the EU. The exception among services is represented by the public sector, which accounts for just over 40% of the Union's productivity levels (see Eurostat).

This particular sectoral distribution of productivity gaps suggests that most of the productivity gains will come in the industrial sector and in the public services, with growth coming predominantly from sectors that provide goods for trade (agriculture and industry), it also suggests that the expansion of the economy will be accompanied by a substantial appreciation of the real exchange rate through the traditional Balassa Samuelson effect. Therefore, catching up savings will come as much from real growth as from appreciation of the real exchange rate. This effect contributes considerably to the catching up. While in real terms the difference in growth rates indicates that it will take a long time to reach the EU level, real appreciation will do so more quickly. While the real GDP of current EU members has increased by 6% per year, the real GDP of the candidate countries has increased by 11.6% per annum from 1995 to 1999, on an intermittent basis. This differential far exceeds that of real growth rates.

It is always easier to calculate the costs for the existing Union than the costs for the acceding countries. Moreover, it is possible that the additional cost for the current Union, in the form of a loss of net transfers, is quite small in relation to the size of the EU economy. The cost for the candidate countries is, on the contrary, considerable. In the accession process, candidate countries are required not only to update their laws and their regulatory framework in order to rise to EU standards, but also to improve their infrastructure, the sewage and water supply.

On the one hand, it would be wrong to consider all the investments required for membership as a cost and not to mention the benefits that will accumulate thanks to these investments. On the other hand, it would also be wrong to ignore them, as do so many studies that analyse the costs and benefits of membership, for two reasons: the requirements related to the protection of the environment that these countries must respect have been designed for the current member countries of the Union. In fact, the barriers have increased considerably since the membership roundtables of the 1980s. Environmental protection is, in itself, a luxury good (i.e. agents are happy to spend a little more money on it). Therefore, without accession, a lot of expenditure in the candidate countries would be deferred. In this way, at least some of the investments should be viewed as a cost of membership; given the huge need for investment in the countries of the region, the investments required in *acquis communataire*-related projects could either replace investments in the private sector or lead to a further increase in account deficits with the associated risks to macroeconomic stability.

According to two recent studies, only the areas of environment and transport require estimated investments totaling about €200 billion. In the environment sector, water pollution and air account for four-fifths of the estimated costs, while in the transportation sector, almost four-fifths are for roads and rail tracks. Assuming that these costs are divided over a period of 20 years for environmental investments, and over a period of 10 years in the road sector, the acceding countries will face, on average, annual investment costs equivalent to 4% of current GDP for the next decade. If one adds to these costs, the expenditure made to meet the requirements of membership in the steel industry, nuclear security, the energy sector, agriculture, telecommunications, social policy and the increase of consumer protection, annual costs could rise, according to some estimates, 11% of regional GDP annually over 10 years. These costs are lower and will be more easily borne by the more advanced countries.

In contrast to the existing framework, with already large public sectors and high statutory tax rates, governments in the candidate countries will find it difficult to increase revenues to meet higher costs. As a result, these countries will have difficulty adjusting their tax accounts if the need arises.

This study was prepared for the Commission as well. It covers the finishing costs of a transport network in the 10 acceding countries, which will represent 18,000 km of roads, 20,000 km of railways, 38 airports, 13 seaports and 49 river ports. The estimates have a time horizon of up to 2015. The 1999 GDP data are taken from EBRD estimates. The figures are calculated as the total investment in euros divided by 20 years as a percentage of GDP in 1999. The 1999 GDP data are taken from EBRD estimates. The figures are calculated as the total investment in euro divided by 10 years as a percentage of GDP in 1999.

At this point in the analysis, it can be reasonably argued that membership in the EU will have a positive aggregate economic impact. However, the implementation of the process also involves the distribution of gains among existing member countries and between member countries and candidate countries. This will determine both the negotiation of the EU budget and the negotiation of transitional periods for certain parts of the *acquis*. The reform of the voting mechanism seems difficult because not only the total size of the Union will change but its composition too. As the average income of EU countries will decrease.

Financial Perspective for 2000-2006 Union (Agenda 2000) is the result of proposals from the European Commission presented in 1997 and the negotiations that followed, until the Berlin European Council in 1999. The most important aspects during these negotiations were the reform of the Common Agricultural Policy (CAP) and the Cohesion Policy in view of the fifth enlargement of the Union. As a result, the budget is set at 1.27% of the Union's GNP until 2006, which covers structural operations, which are experiencing the fastest increase in the last decade, amounting to 0.46% of the Union's GNP. As was already the case, net transfers to individual countries depend on the expenditure side of the budget, as all countries spend roughly the same percentage of their GDP on budget revenues.

This part gives an overview of the current financial structure of the EU and tries to see whether it is sufficient to allow the candidate countries to enter the current framework, with emphasis on two important aspects, namely: structural operations and the common agricultural policy. It seems that, under relatively reasonable assumptions, the Community framework is not able to support the accession of all the favourite countries during this budget period unless certain current recipients renounce some of the their transfers or that transitional periods are used to progressively bring flows to Eastern Europe.

The Community framework provides explicit provisions for accession to the Union from 2002. Approximately €80 billion was therefore allocated for pre- and post-accession assistance for the whole period, which accounts for about 3% GDP of the candidate countries if they all join the Union. With regard to catch-up, the Commission has estimated that acceding countries will grow by 4% a year, compared to an average growth rate of 2% in the existing Union, which is compatible with the experience and the catch-up speed of Spain and Portugal over the last decade.

At the beginning of 2001, the European Commission assured the 15 member countries that with these provisions, the budget could support the cost of the accession of the 12 candidate countries, while keeping a margin for possible unforeseen measures (0.11 % - 0.14% of the Union's GNP). Nevertheless, as the current budget covers 6 years, there are many uncertainties on this subject. In particular, it will depend on: 1. the nominal GDP growth, in euros, of both the Union of 15 countries and that of the candidate countries; 2.the absorption capacity of the candidate countries, especially as regards the Structural Funds; 3. the end of the accession negotiations, during which the rules for the allocation of funds are subject to change.

In conclusion, given the provisions and assumptions made for membership in the current structure, implementation would be possible within the current budget margins. This is especially true if the Union is able to keep the funds for membership for the years 2002 to 2004, when there will probably be no new members. There are two main areas of uncertainty about the budget. First, the current budget does not provide for direct income support for farmers in an enlarged Union. Secondly, if the speed of the real appreciation in the candidate countries persists, it is unlikely that the provisions for structural transfers will be insufficient and they may need to be supplemented by funds which would normally have been used by the countries concerned. However, it is unlikely that there will be any substantial changes in the net transfers of any of the current members of the Union during this budget structure. This could very well change in the next budget structure, and much will depend on the fact that the acceding countries to vote in the new structure or they are forced to accept to enter the Union.

The main problem of this period comes from the costs of investment related to the *acquis*. Their result probably does not justify the investment, since they would not be a priority if there was no membership. As they are not sufficiently covered by transfers within the framework of structural operations, they will be a heavy burden for the candidate countries.

Similarly to previous accessions, this fifth enlargement will probably have a lasting effect on the EU, both in terms of what the EU does in terms of the budget. The candidate countries have quite different levels of income, the rich countries of Northern Europe have different problems, and the future Union will have to reflect all their preferences. In particular, this will have budgetary implications. The enlargement of the Union could reinforce the possibility of a considerable budgetary increase for the next financial perspective (2007-2013).

Previous accessions, such as those of Ireland, Greece, Portugal and Spain had led to fundamental changes in the Union budget. In fact, before the accession of these countries, the main objective of the Union was to help European countries in the field of subsidies to the agricultural and steel sectors. During the 1980s and early 1990s, the Delors I and Delors II agreements represented a reform of the Structural Funds but also an increase in their amount (1988-1999). Resulting largely from the accession of the poorer Mediterranean countries, the share of agriculture in the European budget has increased from 90% in 1970 to less than 50% in the current structure, and has been replaced by structural operations. Even if the Union is not a country in which voters decide on the optimal level of redistribution, some elements of this mechanism are present, and the stronger the integration, the more these elements will develop. In fact, Baldwin et al. (2000) show that the proportion of votes of poor countries in the Union is very strongly correlated with the proportion of structural operations in the budget. The significance of the impact will strongly depend on how the voting process is reformed.

Therefore, although enlargement may in fact only represent a redistribution of the existing structural funds, it would be surprising if the total amount of these transfers is not increased in the next budget. None of the current recipients will be happy to give up some transfers, even if, according to the current eligibility criteria, most of the current recipients of the Structural Funds would no longer be eligible in the future. The magnitude of the effect will depend heavily on the reform of the voting mechanism.

The increase could result either from lower agricultural spending with a new designation of agricultural policies back to individual countries, or from an increase in the total budget. Michel Barnier, Commissioner for Regional Policy, says that the Commission is seeking a solution to this problem. Nevertheless, his work is complicated by the fact that he knows neither the candidates who will join the Union, nor the terms and date of accession. According to him, there are several possibilities that the Commission is studying with regard to changing the rules, in order to soften the impact on the current net recipients of the Structural Funds. These include raising the structural fund eligibility threshold from 75 to 90% of the Union's GDP, or setting different EU thresholds for existing members and for new Member States. In addition, it states that unemployment rates could be used as a basis for calculation instead of wealth or that the ceiling for structural assistance could be raised from 0.45% to 0.66% of the Union's GDP. It therefore appears that the EU anticipates that additional funds for structural operations will have to be found. Since it would be difficult in the current climate to ask member countries for additional funds, the idea of eliminating agricultural aid is being studied as an alternative. The chosen path will depend on the new organisation of voting rights. This also explains why a country like France, the largest recipient of agricultural aid, is very worried about the change in voting rights. Other countries are also worried about having to pay more. German Foreign Minister Joschka Fischer told the Financial Times that Germany cannot support the special requirements of other member states in order to win the agreement for enlargement.

The candidate countries want to ensure equal treatment after accession, especially with regard to direct payments to farmers. They also want to participate in the quarterly review of the CAP. Applicants state that this review should not become a barrier in the negotiation process. Given that current agricultural policies are largely revised following recent scandals, some Nordic countries have decided to change the focus of their agricultural policies, far from the traditional support for intensive agriculture. As a result, the interests of the Union's member countries in agricultural policy are becoming more and more varied, which would ultimately mean that at least part of the agricultural policy will be sent back to the national governments. The prospect of membership of Eastern European countries, with their important but very different agricultural sectors, is likely to accelerate this process.

The extension of the current CAP to the east entails considerable risks. The candidate countries have important farmland and a large part of the labour force, especially in Poland and the Baltic countries, has chosen agriculture because of the lack of work in the other sectors. In fact, agriculture probably to some extent replaces the lack or inadequacy of social security services. Direct income support payments, comparable to those paid in the EU, could perhaps change motivations to a certain extent, which would discourage these people from leaving the agricultural sector.

The benefits of EU membership for each country will depend heavily how decisions will be made within the Union. The current decision-making mechanisms are, for the most part, considered ineffective, and will probably become so once the Eastern European countries have joined the Union. Ideally, an analysis of the voting mechanism would require knowledge of all future questions put to the vote, in order to see whether all the optimal results are achieved in relation to an established welfare function. In reality, there is neither an established welfare function nor perfect knowledge of all the future decisions that will have to be made. However, some lessons can be learned using slightly flawed statistical measures such as Baldwin et al. (2000). Looking at the probability of adoption, a measure that captures the likelihood that a movement will occur, they show that 14.7% which is the value at which it arose when the Union was formed, it fell to 7.8% after the last enlargement (the Union of 15). Bringing only 5 Eastern European countries into the Union would reduce the probability to 3.7%, making any decision in the Union impossible. This dilemma has been clearly recognised by the governments of the countries of the Union, and is at the top of the reform agenda. In fact, at the Nice summit, the voting model was slightly modified, but according to the same authors it made things worse. The main conclusion of their work is that unless one reduces the current relative majority by 71%, it will be difficult to implement a mechanism that keeps the Union operational. In order to answer questions of legitimacy, the authors propose that the Union should move towards a double majority in its voting system, i.e. that in order to pass a motion, it is necessary to have a majority of the member countries and a majority of the Union's population. If the Common Agricultural Policy is returned to the nation states, agricultural transfers from the EU budget are likely to fall. The biggest loser, in monetary terms, of this change is probably France, but the statements of the European Commission suggest that the Commission takes this option seriously into account. It would be particularly important to lower the threshold necessary for the majority, in order to prevent certain coalitions from paralysing the Union. As mentioned before, a recurrent pattern of the Union foresees the division of resources between the CAP and structural operations.

The former mainly benefits the rich countries of the North, for which it was originally conceived, while the second mainly benefits the members Union. If all the countries of Eastern Europe joined the Union, countries which would probably benefit more from structural operations than agricultural aid, they could commit themselves to the last members of the Union, in order to constitute the coalition of ‘poor’ countries. Given the current voting mechanism, this coalition could easily block any advanced decision and could use blocking tactics to attract more funds into structural operations. This type of tactics is not unknown in the history of the Union. Therefore, this is a real problem, and unless the blocking threshold is lowered, the Union could be paralysed in its budget decisions. Unfortunately, this has not been accomplished until difficult issues such as regional aid, labour migration and agriculture are discussed.

This entails the risk that the reform of the voting mechanism will be blocked in the enlargement negotiations of the Union.

There are clearly gains to be made for both sides in anticipating the accession, the existing Union and the central European countries. It is possible that both gains and costs are considerably higher in the acceding countries when compared to the size of their economies. Moreover, it is possible that there are groups and countries on both sides that earn more than others and that this distribution of gains and losses complicates the influence of enlargement. While it is difficult to determine individual gains and losses accurately, some aspects of differentiation have been qualitatively highlighted. The distribution of gains and losses will depend on the negotiation of the Union budget, both the current budget and the future budget, which itself will depend on the reform of the voting mechanism. An additional dimension of negotiation is opened by the Union's willingness to accept long transition periods and differential treatment of individual countries. As a result, there will be considerable negotiation work between the existing Member States, the Union and the acceding countries. Moreover, recent years have seen the idea that the Union was losing the support of its population. Whenever the Union submitted one of its treaties to the people, the majority was far from consensus and some treaties were entirely rejected as the Treaty of Nice by the Irish. Worse, some of these rejections appear more as a vote of protest against Brussels than a disagreement with the issues covered by the referendum, thus affecting the legitimacy of the Community institutions. Therefore, it is important that there is a significant majority for enlargement, both within the Member States and within the acceding countries.

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