

THE REASONS WHY NEW WAVES OF EU ENLARGEMENTS ARE NEEDED

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Abstract. *The integration process raised many doubts, including the concerns about the capacity of the EU institutions to absorb the wider variety of opinions that would have to be taken into account in the decision-making process. Questions were raised about the costs of the enlargement, as most of the newcomers had significantly lower income levels than the average of the incumbent Member States.*

Key Words: *Accession process, acquis communautaire.*

Europe witnessed spectacular changes in its economic, social and political landscape during the last decade. Equally remarkable are the forthcoming changes over the new decade. The past and the forthcoming changes in Europe manifest themselves, among other things, by dramatic reshaping in the positions of the countries, of their economic systems, of the economic, social, professional, generational, regional and other interests. The Eastern enlargement of the EU is a strategic undertaking, aiming at economic, social and political well-being for all European countries and their people. The last waves of enlargement were a historic step in the reunification of Europe. With ten countries acceding in 2004 and further two in 2007, this enlargement round of the EU was the largest, in terms of both the number of countries and population. Most relevant feature was that it brought together countries that had experienced very different economic, social and political developments. It was a milestone in unifying Europe after several decades of artificial division resulting from the Cold War. Overall, this enlargement was a major success for the EU and its citizens.

1. EUROPEAN UNION AND THE NEW MEMBERS

The enlargement process has helped build and consolidate democracy after the demise of the communist regimes. It has strengthened European security, by providing a crucial anchor of stability in a period of conflicts and upheavals within and around Europe. It has greatly boosted the economies and improved living standards in the new Member States, thereby also benefiting the old member states notably through new export and investment opportunities. It has strengthened the economy of the Union as a whole, through the advantages of integration into a larger internal market. Enlargement has also enabled the EU to reap more fully the benefits of globalisation. An enlarged EU has more weight when addressing issues such as the world climate change or the international financial crisis. The integration process raised many doubts, including concerns about the capacity of the EU institutions to absorb the wider variety of opinions that would have to be taken into account in the decision-making process. Questions were raised about the costs of the enlargement, as most of the newcomers had significantly lower income levels than the average of the incumbent Member States. Not surprisingly, EU citizens had mixed feelings and saw risks in terms of their jobs, wages, security and identity. The global financial crisis and economic slowdown is adding another dimension that puts a strain on the integration and convergence already achieved. The advantages of inclusion, a wider Europe and increased market access, will need to be balanced against the costs and challenges of adjustment.

Therefore the last enlargements were the most complex and different from the others as they were the largest in terms of the number of acceding countries and the size of their population. Most importantly, on average the recently acceded countries had significantly lower levels of income than the average of the incumbent Member States compared to the countries that had joined the EU previously and whose economic, social and political backgrounds had been very different. It made the integration process a formidable challenge, for both the new and the old Member States, but at the same time provided notable opportunities for the individual countries and the EU as a whole. The success of this endeavor needs to be judged against the background of the huge challenge of reuniting Europe in the aftermath of the fall of the socialist regimes in the East. Given that - except for Cyprus and Malta - the aspiring EU members were former socialist countries with centrally planned economies, some fundamental transformations were necessary that would allow these countries to adopt the "acquis communautaire" and integrate into the EU's system of political and economic governance.

That is why the accession process officially started as early as 1993, when the Copenhagen European Council issued the invitation to apply for membership. The European Council set out the "Copenhagen criteria", which were the economic, political and legislative criteria that applicants had to meet before membership could be considered. Enlargement has conferred significant benefits on all parties involved by anchoring the economic and political life of the new Member States. Even in the most thoroughly designed social projects, however, there is no guarantee that everybody will get equal gains at the same time. The overall aggregate outcome may be positive, but it may not be equally beneficial for all participants in the integration process. Economic theory provides no assurances that all economic agents benefit from the integration. Behind the positive total outcome of the expanded EU, there will inevitably be partial misbalances, which

occur as losing countries, regions or groups of the population. The positive and the negative effects will not be shared evenly. Some countries, regions and sectors may get positive effects at the beginning, and later on may transform into losers. Some may get direct positive and negative effects, while others get them indirectly.

While the newly acceding Member States accounted for about 21% of the EU population, they contributed only about 7% of GDP. As economic growth in the new Member States is significantly stronger, the initial income gap relative to the EU average is narrowing. However, the benefits of the last enlargements are primarily not due to the slightly higher overall weight of the EU-27 in world GDP (by around 2.5 percentage points in purchasing power standards), but to the synergies and economic dynamism that this association of Member States has made possible, enabling better answers to be formulated to address the challenges posed by globalization. After a transition-related recession in the early nineties, the economies of the new Member States stabilized and received a boost to their growth in the second half of the nineties in the light of accession which had become a distinct possibility. Output growth accelerated further on the EU entry in 2004, accompanied by strong job creation in most countries after several years of labour shedding related to economic restructuring. In the 5 years after accession, average GDP growth in the new Member States amounted to 5½ %, compared with 3½ % in the preceding 5 years, while growth in the old Member States remained at around 2¼ %. In line with the global slowdown brought about by the credit crisis in the US and rising energy and commodity prices, activity weakened in 2008, particularly in the Baltic States. Key drivers of the growth process in the new Member States were trade openness, foreign direct investment and an overall improvement in the institutional framework to which accession contributed decisively. These factors led to an acceleration of productivity growth, which is the basis for an enduring increase in the standard of living.

Possible elements of success were the productivity improvements due to FDI and the associated transfer of technology. The stronger growth performance enabled the new Member States to catch up in terms of GDP per capita from some 40% of the EU-15 average five years before enlargement to 52% in 2008. The real convergence process in some countries was faster than in others, highlighting the importance of having the appropriate policies in place. Starting from low-income levels, catching up appeared particularly impressive in the Baltic States, but the overheating that followed has been taking its toll since 2007. Growth in the old Member States was about half of that observed in the new Member States, with weak performances in some larger countries, but this cannot be attributed to enlargement. On the contrary, the old Member States benefited from the growth pole formed by their neighbors. Ex ante estimates made by the Commission in 2001 indicated an additional growth stimulus of 0.5 % or 0.7 % at the end of the period examined, namely 2009. These numbers could not be verified, but what is clear is that those EU-15 countries with higher growth rates in their FDI and trade activity with the new Member States have also enjoyed larger increases in their real per capita GDP growth rates. Furthermore, EU membership helped overcome the lack of savings in the new Member States. This led to a catching-up model based on capital imports, which prompted current account deficits and appreciation of real exchange rates. However, the strengthening currency did not depress the export performance of the new Member States as inflows of foreign direct investment allowed a quality upgrade of the export basket. By contrast, since the 1997 financial crisis the catching-up approach practiced by the South-east Asian countries has relied on cheap currencies and current account surpluses.

2. EUROPEAN UNION AND POTENTIAL MEMBERS

Major features of the European integration during the last ten years were the short-term actions and capturing of short-term benefits. The EU companies benefited from the liberalization of trade and capital flows. They increased exports to Serbia and other CEECs on readily available markets, doing almost nothing for their development. Moreover, their trade surpluses kept growing. The West European companies were major beneficiaries through exports of modern capital goods for structural and technological modernization of the CEE economies. The size of these exports will be much larger over the coming years within the context of their preparation for EU accession. The large negative trade saldo of the CEE countries should be treated as their costs over the past decade. This is likely to go on for the new decade. Trade liberalization was more beneficial for the EU countries as they were better prepared than the CEECs. Although unprepared, the CEECs were compelled to open their markets for goods and services from the EU bearing heavy economic and social consequences, being unable to benefit from "jocks" (accesses to EU structural and social funds), or "vents" (emigration of a redundant man power, generated by import competition). Greece, Portugal and Spain were treated more fairly in this respect. They have got and continue to receive 40 - 60 times more net EU transfers per capita than the CEECs. The same is true for the liberalization of capital flows, although the benefits were shared less unevenly between the partners.

The net benefit in favour of the EU was (and is) most pronounced in sharing benefits from labour migration. The EU countries have nearly blocked the migration flows. This is good for them, but heightens the tension on the CEECs labour markets at a time of drastic structural adjustments to prepare for accession. The net positive effects of the EU countries are even larger and these of the CEECs –smaller from the EU governments' policies to attract highly skilled experts from the East. This affects the CEECs negatively and will go on increasing over the coming years and decades. The analysis confirms an obvious asymmetry in sharing of net effects from liberalization (or lack thereof) so far between the EU and the CEE along the major integration flows. The EU companies have already captured a large proportion of the positive effects from these flows. The CEECs sustained so far predominantly negative effects (costs for accession preparation, losses from import competition, accumulated trade deficits, losses from skilled labour emigration) and got only meager positive effects. The short- and medium term overall net effects for the EU countries were obviously positive, while for the CEECs – clearly negative. The same holds true for Serbia. The composition of accession preparation costs also deserves attention. One can see in Fig. no 1. that EU pre-accession transfers will be around 5% of the overall investment during 2000-2005, and 10% for the second half of the decade. The EU transfers are expected to cover up to 15% of the investments directly related to accession preparation.

Under the present situation of ongoing accession negotiations the solution is a full mobilization of the national energy for the best possible preparation for accession at the most favorable terms feasible. It is easy to be said and very difficult to be implemented. As stated above, a comprehensive measurement of positive and negative effects of integration is not possible. The most one can estimate now is a tentative picture of the trends of these effects and their tentative sharing between the EU and the applicant countries. They can be presented in a graphical form. This is more of a qualitative than a quantitative estimate. Any attempt even for such qualitative assessment contains a number of conditionalities. Such

estimates should be interpreted cautiously and serve only as a starting point for reflection and further comprehensive investigation. In figure 1 one can see (qualitative) graphic assessment of the new revenues Serbia expects from EU transfers prior to and after accession.

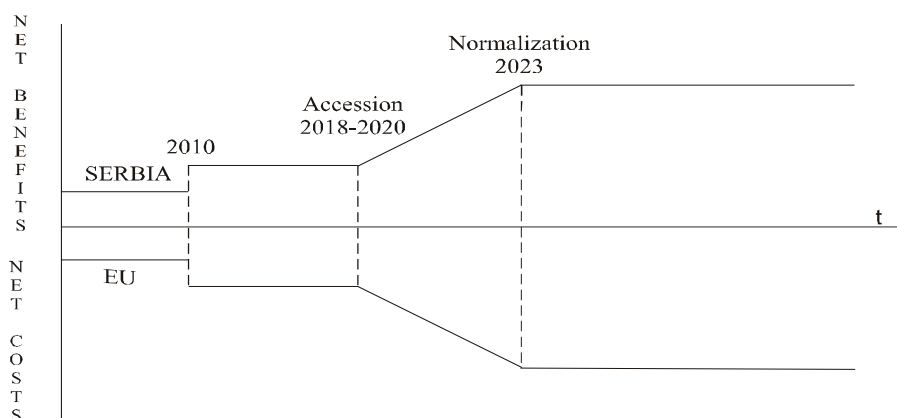


Fig. 1 EU pre-and post accession transfers

During the first half of the pre-accession period (2000–2005) Serbia got annual gross budget transfers from EU around 260 mill. Euro. During the second half (2006–2010) – after the accession of the first group of applicants the transfers will probably double. One assumes that the pattern of gradual switching into EU agricultural, structural and other funds, envisaged for the first group of new members will be applied to Serbia from 2018 to 2020. As it is impossible to forecast transfers beyond 2020 (which is assumed as a normal one) we expect they will remain at least at the same level over the following years. The assessment of these costs is more difficult than of budget transfers.

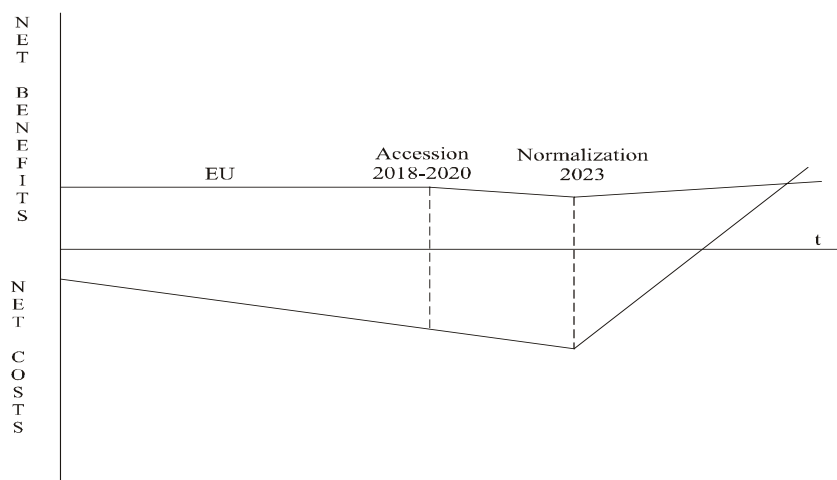


Fig. 2 Overall net benefits and costs of Serbia's accession

Figure 2 provides a general (qualitative) graphic expression of what has been said so far concerning the short-, medium- and long-term effects. This graphic is totally different from similar experiments of West European experts. Both numerically and graphically they present different sharing of integration effects between CEECs and the EU. They estimate positive net overall effects for the CEECs both before and after accession. The effects increase sharply after accession. Net effects for the EU are estimated as slightly positive, but smaller than the net positive effects for the CEECs before accession. They decline sharply after accession and stay negative for many years tending towards the zero in the distant future. Even then, they are expected to be much smaller than the overall net positive effects for the CEECs. The net effects for Serbia will stay negative during the pre-accession period (by 2020) and afterwards until normalization of its status as EU member (tentatively by 2023). Their negative size will grow up to accession. It will go on increasing, though at a lower pace, by 2025 (tentatively) because of:

1. low level of economic and social development – the lowest among the applicant countries;
2. too short preparatory period, particularly taking into account the backwardness of the country;
3. huge investments needed for convergence with the EU standards within a short period of time and limited transition periods;
4. modest transfers from the EU pre-accession funds;
5. gradual switching in to agrarian, structural and other funds after accession;
6. expected curtailment of agrarian, structural and other transfers to new EU members, compared to their levels up to 2000;

A major reason for the negative overall effect is that Serbia and the other applicant countries have been left alone to bear the bulk of the costs for preparation. They will have to be financed from domestic saving by an economy which is in a deep recession; additional external borrowing at already high external indebtedness; attracting FDI at unfavorable investment environment. On top of that, efficiency of economic activity in this country is low, and will remain such for many years to come. The main reasons for this are domestic. If one looks for external reasons, they are in the EU, which is not willing, or able to provide larger transfers prior to and after accession, symmetric to the short pre-accession period and the limited transitional arrangements. Here, too, caution is needed in the assessment, as the EU member countries have their own problems, constraints and interests. If we were them, we certainly would have given preference to our national interests and would have behaved in the same way!

As stated above, Serbia as many of Western Balkan countries must provide the bulk from domestic saving, FDI, and external loans. This will burden the budget with infrastructure investment and public debt servicing, while revenues from import tariffs will be on decline, due to trade liberalization. As a result, the external debt servicing will be even more difficult. This will necessitate greater economic and social mobilization, in spite of accumulated social fatigue from transition and high expectations for better incomes and consumption. The burden of accession preparation costs will grow year after year during the pre-accession period and also after accession. Particularly over the 4-5 years after accession, if the present pattern of gradual switching in to EU funds is to be applied for the second wave of new members.

One could argue that the constructive external pressure for faster compliance with the Acquis and related standards would accelerate modernization of CEECs. This may be true if such pressure was exercised over countries with financial and other capacities for modernization. For some of the CEECs, and particularly for Serbia, this is not the case. For the more backward CEECs still in transition recession, the external pressure would be constructive if supplemented by financial assistance. In the absence of such support it would not lead to anything beneficial. One should also bear in mind that these standards were designed for advanced European countries, and developed over many decades with huge resources. The CEECs are not in a position to meet these standards within much shorter time, much smaller resources and less favorable environment. In addition to time and resources needed, compliance with technological, ecological, social and other standards of the EU by CEE companies will be damaging to their cost competitiveness, at least in short- and medium term. This would crowd them out from traditional markets for a long time.

Serbia and other CEECs countries are burdened excessively due to overlapping of the transition and preparation for accession. It is well known that transition necessitates large costs for restructuring of the real and financial sectors, development of technical and institutional infrastructure and many other components of the functioning market economy. And this must be done by weak exhausted economies due to the deep recession and radical transformation of the economic systems. The private sector is expected by definition to perform better and be helpful to the state and society. In the short term (in Serbia - in the medium term) the poor quality private sector will not be loyal to society. Of course, this does not apply to the entire private sector, but only to the portion, which is in the gray area between law and crime. As a matter of fact, much of this private sector was initiated in semi-criminal environment. It is very active and inventive in tax, customs and social security payments evasion, violation of labour code, etc. As a result, for several years after privatization, the economy is in a poorer shape than before privatization. The post-privatization ailing may last longer in Serbia. Serbia and other transition countries are burdened by additional costs for compliance with the EU standards in this complex environment. The CE countries, more advanced in transition, are better prepared for accession and can afford the related costs more easily. The countries, which have not yet solved the most acute transition problems (such as Serbia), must carry on the two at the same time – market transformation and preparation for accession, and burden themselves with two types of costs. It is true that the two processes are complementary, but their sequential implementation is less painful than the simultaneous one.

It is logical to expect that the progress of transition and preparation for accession accumulates a potential for higher growth, productivity, competitiveness, employment and incomes and not only costs. This will produce economic and social relief for the population. It is logical indeed for most of the CE countries, but not for Serbia – backward both in transition and in preparation for accession. The Serbian economy is and will be in the foreseeable future at a stage of development of economic, institutional, social and other prerequisites for both - transition and preparation for accession. This means - at a phase of investing. It has not yet reached the indispensable minimum of economic maturity to "harvest the fruits" of these investments. With appropriate economic policy and enhanced preparation for accession the more favorable stages of development and maturation may start surfacing after 6–7 years, at the earliest. More visible results are to be expected later on. From the above it follows that the EU countries first capture the benefits from inte-

gration (liberalized trade and capital flows, large exports of capital goods to transition countries, large trade surpluses, participation in speeded up privatization, blocking of migration flows for low-skilled labour, and draining the most skilled experts). Only later on they will make expenditures (potential transfers, opening labour markets) for aiding the CEECs. Only a comparison of accumulated trade surpluses with transfers made so far and promised for the future proves that short- and medium term net effect is positive for the EU and negative for the CEECs. This is true for Serbia as well.

The longer this asymmetry lasts, not only in the size of the positive and negative effects, but also in their sequencing in time, the larger the positive effects for the EU and the negative ones for the CEE. Other researchers of the effects of integration of CEECs into the EU draw similar conclusions. The applicant countries in the Eastern enlargement are placed from this point of view in less favorable position than were the applicants for the Southern enlargement in the 80s. It is well known that from an economic point of view one cannot commensurate nominal figures occurring at different time. One \$ worth of profit today is much more valuable than \$ 1 five years from now, and even more so, than 10 years from today. The opposite is true for costs. The sequencing of the effects of CEECs integration so far, and the expected one for the new decade, taking into account the "time factor", leads to the following conclusion: The net present value of the overall positive effect for the EU is much larger, than the net present value of the overall positive effect for CEE. To be precise – in the short- and medium term there is no positive overall net effect for CEE, either nominal, or discounted. The net present value of negative effect for CEECs is more unfavorable than the net nominal negative effect as a sum of nominal annual numbers.

The transfers from the pre-accession funds are useful and indispensable for Serbia and the other applicant countries. They are free and, therefore, provided under more favorable terms, than the softest official loans. However, one has to state that these transfers are not beneficence to Serbia and the other applicant countries, made despite the interests of the donors. The utilization of the transfers proves that they are at the same time a form of self-financing the economies, the budgets and the citizens of the donor countries. The transfers are used for consultants' fees from the donor countries, 30-50 fold higher than fees for local experts of comparable quality (and part of them goes to their budgets as income tax). The funds are used for engineering – designing services, provided predominantly from the donor countries' companies (and part of them contributes to their budgets as corporate and income taxes, and VAT). They are used for procurement of equipment, technologies, information, software, transport and insurance costs, and others, again by companies from the same countries (and part of them transforms into budget proceeds as taxes). A portion of these resources transfers into contributions to the social security systems of the EU countries. It would therefore be more appropriate to say that pre-accession transfers are free assistance to the applicant countries, which matches adequately the interests of the EU members

On the whole, the relative income gap between old, new and potential countries is slowly closing, but the distribution of the enlargement dividend within the countries is not proportional, with some regions benefiting more than others. This is due to the fact that capital and skilled labour tend to concentrate in a limited number of regions during the initial phase of the catching-up process. When a certain stage of development is reached, knowledge spillovers and the disadvantages of agglomeration (e.g. labour shortages) come to the fore and a more balanced income distribution is likely to be achieved. Real convergence went hand in hand with considerable progress in nominal convergence as inflation rates, interest rates and

government deficits approached the levels that were being seen in the old Member States. However, from mid-2007, as a consequence of the financial crisis, macro-financial stability came under pressure in several new Member States with Hungary and Latvia asking for balance of payments support to overcome liquidity constraints. This reassessment of risk in emerging markets, in turn, is leading to a significant contraction in economic activity in many new Member States of which some are likely to see, at least temporarily, a widening of the income gap with their richer neighbors in the EU.

Therefore enlargement must be fair and the people should be able to feel it. Temporary deviations in the sharing of the net effects among countries, regions and social groups are possible, but they should not last for a long time. If people feel that year after year the benefits go to some of the countries while the others bear the costs, misgivings and tension may emerge. The past ten years have witnessed asymmetry in the sharing of positive and negative effects by the EU (new and old members) and the CEECs. Further tolerance, keeping silent and postponement of appropriate decisions benefit nobody. As already stated, Serbia and the other CEECs have no viable alternative to accession. It is, however, of fundamental importance not to allow shortsightedness to discredit this brilliant gigantic undertaking.

Overall, the initial expectations around the benefits of enlargement to the East were positive, among both experts and the public, and especially in the new Member States. However, the various benefits associated with the last waves of enlargement came at a cost in terms of adjustment, which gradually translated into the current "enlargement fatigue". Nonetheless, the enlargement policy continues to be supported by a relatively large share of the EU population, even in the current difficult context of economic slowdown and global financial distress.

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ZAŠTO SU POTREBNI NOVI "TALASI" PROŠIRENJA EU?

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Proces integracije sa sobom nosi velike sumnje, uključujući brigu vezanu za apsorpcioni kapacitet institucija EU da uvažava raznovrsnost mišljenja koje bi trebalo uzeti u obzir u procesu donošenja odluka. Vrlo važna su i pitanja u vezi troškova proširenja, s obzirom da je većina novopridruženih zemalja imala znatno niži nivo dohotka u odnosu na prosek "starih" zemalja članica.

Ključne reči: *proces proširenja, acquis communautaire.*