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Europe’s Eastern Enlargement: Who Benefits?

JOHN HALL AND WOLFGANG QUAISSER

The European Union is preparing to take a quantum leap eastward. For the EU, previous rounds of enlargement meant adding tens of millions of West Europeans. In contrast, its current plans for enlargement mean adding between 100 million and 200 million new citizens from central, eastern, and southeastern Europe. Will such an unprecedented enlargement make the union that much more perfect? Or might the planned expansion generate such high levels of dissension between and among member countries that the future of this grand experiment in integration is threatened?

Fifteen countries currently compose the EU. Its eastern enlargement means bringing in as many as 12 more countries, likely entering as two or three groups spaced over time. If all goes as scheduled, just after 2010 the population of the EU should approach 500 million. Its population will be significantly larger than that of the United States.

In recent decades the EU has allowed a small number of countries—Ireland, Spain, Portugal, and Greece—with per capita incomes well below the EU average to join. Over time it became clear that membership did allow these countries to escape their historical problems of persistent poverty and industrial backwardness. According to a wide range of statistical indicators, Ireland, Spain, and Portugal have made significant strides in converging toward the EU per capita GDP average.

But eastern enlargement poses a more formidable challenge, one that has generated a set of deep-seated fears mumbled by Western Europe’s forgotten public: Could the visions of Europe’s elite leaders backfire, threatening and even undermining hard-earned prosperity by extending the EU too far

eastward? Citizens to the east ponder: Is the European Union’s current scheme for enlargement as virtuous as purported? Is this in reality a quickly spun stop-gap measure to shore up security risks along a newly formed eastern border created by the Soviet Union’s unexpected demise? The historical experience of the East European countries is to dance to the tunes played by regional powers to their west and to their east. Is this just one more round, with Brussels choreographing the show now, rather than Vienna, Berlin, or Moscow?

CREATING EUROPE’S NEW DIVIDE?

For a full decade, the Central and East European Countries (CEECs) have undergone transitions from authoritarian, one-party rule to parliamentary democracies, and from planned to market economies. Hungary and Slovenia are judged to have nearly completed their economic transitions and are mostly prepared for their accessions to the EU. Other countries remain farther behind.

The European Commission provides criteria for judging a country’s preparedness for accession. The Brussels-based commission annually evaluates countries to determine if each has fulfilled the “Copenhagen Criteria” regarding the establishment of stable institutions guaranteeing pluralistic democracy, the rule of law, and respect for human rights, including protection of national minorities. Its economic criteria presupposes the existence of a functioning market economy. Likewise, candidate countries are evaluated to see if they have implemented the *Acquis Communautaire* (what has to be acquired to belong to the community), the common set of rules, laws, regulatory systems, and institutions that serve as a precondition for fulfilling the EU’s common goals.

What makes the EU’s eastern enlargement so challenging economically? Foremost are the sys-

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temic changes candidate countries confront at home as they abandon legacies of failed communist experiments and embrace the West European model based on democracy and a liberal market economy. The second challenge is the unprecedented scale and speed of the anticipated expansion. In addition, vast differences exist in the levels of economic development and economic performances between the prospective CEECS and the advanced members of the EU.

Levels of capital endowment and technical development are also more extreme than were the differences between the advanced economies in Western Europe and Ireland in 1973, and Portugal, Spain, and Greece at the time of the southern enlargement in the 1980s. Portugal registered at least 30 percent of the EU's per capita output when it joined the EU; Ireland and Spain were roughly at 60 percent of the EU's per capita GDP, and Greece was at 50 percent. However, when measured at current exchange rates, the average level of per capita output in 10 of the CEECS under consideration is only 16 percent of the current EU average. More advanced CEECS, such as the Czech Republic, Poland, and Hungary, are at between 18 and 20 percent of the EU average. Although Slovenia registers at 44 percent of the average EU per capita GDP, it is a small country and its population of only 2 million would increase the EU's size by less than 0.6 percent. Compared to the CEECS, the Balkan countries, as well as Moldova, Ukraine, Belarus, and Russia, are generally poorer, exhibiting significantly lower levels of per capita GDP relative to the EU average. With eastern enlargement, Europe seems to be creating its own new divide.

Which of the CEECS will be invited to join the "rich man's club," and when?¹ The stakes are high. Those invited can expect to prosper, since they will benefit from the EU's agricultural and structural funds—transfers that could be as large as 4 percent

¹The selection of countries that will enter in first, second, and even third rounds is not completely settled. Most likely, those countries that have done the most to fulfill the economic criteria will enter first. A "big bang," however, is also likely, with as many as eight countries entering together in 2005 or 2006.

²Darius K. Rosati, "Economic Disparities in Central and Eastern Europe and the Impact of EU Enlargement" (Warsaw: Central European Initiative and the United Nations Economic Commission for Europe, 1999).

of their GDPs. These transfers could continue to flow in for decades, as they have for Ireland. In addition, those chosen will benefit from insider access to the largest single market on earth.

However, as those countries entering the European Union see their economic indicators dramatically accelerate toward EU averages, the countries beyond the EU periphery are expected to fall relatively farther behind. As Darius Rosati has so cogently warned, other countries—farther east in Europe and farther south in the Balkans—surely will never be invited to join the EU, and thus will be left out in the cold: left to manage their economic and associated societal problems without the largesse of massive fund transfers, full market access, and the stability offered by well-funded and competently staffed EU institutions.² Even after an eastward expansion, the EU will likely find that the levels of instability, related to high rates of unemployment and comparatively large populations facing persistent poverty just beyond its eastern and southeastern borders, will remain, threatening the EU's clublike atmosphere.

Yet the countries benefiting from the privileges associated with entering the union will

face their own share of challenges. Economic preconditions for accession and then full union participation are now higher than they were in the 1970s or 1980s, when countries with lower per capita incomes entered. Brussels introduced additional steps for integration in the 1990s, such as the Single Market Program and the European Monetary Union (EMU). Following EU accession, countries that want to join the EMU must bring into and keep in line rates of inflation, federal budget deficits, and the ratios between total public-sector debt and GDP.

Union membership also means that a member country's firms must integrate into—and then survive in—a single, Europe-wide market. Integration must be achieved in an economic environment in which, even over the long run, levels of labor productivity between members countries will vary significantly. In sum, rising entry standards make joining the EU much more costly and administratively difficult to undertake for the accession hopefuls when compared with what other countries faced when they joined the EU in previous decades.

Entering countries may also not be offered the same large subsidies to assist farmers and funds for

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infrastructure improvements that were offered Ireland, Portugal, Spain, and Greece. With comparatively high levels of education and training, the CEEC labor force is lined up and eager to fill higher-paying jobs in the West. However, accession policies will allow individual EU countries to restrict the free movement of labor. Thus, the CEEC workforce will likely face the prospect of sitting at home for up to seven years in what is being euphemistically termed a "transition period" that will allow West European countries to protect their labor markets from the inflow of eastern workers.

If the problems and costs that Europe faces with eastern enlargement outweigh the expected benefits, what keeps the dream of eastern enlargement moving forward? The obvious answer is that eastern enlargement can be considered an essential aspect to fulfilling a political vision. Europe's unification was spelled out as a goal in the 1957 Treaty of Rome. But bringing to realization that unanimous political vision would be difficult—if not impossible—were it not that economic theory is also on the side of enlargement.

At least two major studies suggest that existing EU members can expect modest growth in output resulting from integration. Future growth is estimated as modest since a sizeable portion of potential growth effects were realized shortly after trade liberalization with the CEECs in 1992. The average jump in GDP after the start of accession is expected to range from 0.2 to 0.5 percent of current levels of GDP for most CEECs, although comparatively larger select CEECs can see an increase of between 5 and 7 percent of their current GDP.

On the down side, EU members have started to show signs of divisions that will likely deepen over time as countries estimate their prospects for future gains and losses associated with eastern enlargement. At the December 2000 Nice summit, EU members started to deal with a range of issues related to their voting power relative to other EU members and the countries lining up for accession. With enlargement and an anticipated restructuring of power relations on the horizon, some EU member countries are jockeying to gain positions that will help maximize their gains and minimize their losses.

Austria, Germany, Scandinavia (excluding Denmark), and the Benelux countries (Belgium, the Netherlands, and Luxembourg) are expected to pay more to Brussels but to gain even more through an increase in economic activity with the CEECs. Because of their close geographic proximity, Austria and Germany expect to reap the largest economic

benefits from eastern enlargement as CEEC markets expand for their export products. France is expected to pay more but find less returned. A third group, composed of Ireland, Portugal, Spain, and Greece, faces the possibility of losing existing levels of net subsidies, but will remain net beneficiaries of transfers for the foreseeable future. Britain and Denmark should expect neither net gains nor losses.

EU members thus appear to be basing their support (or lack thereof) for eastern enlargement on whether they will benefit or lose when Brussels issues future budgets. In addition, EU countries are calculating how their economies will integrate into an enlarged union.

Trade—as exports from the CEECs to the EU—is estimated to be too small to significantly affect prices in Western Europe commodity markets. Border openings have already affected wages and levels of aggregate employment in the West, but these have been and are expected to remain marginal. CEEC import penetration is expected to continue to exert downward pressures on wages in the apparel and metal industries while also generating additional unemployment. However, a sizeable portion of expected losses has already been absorbed since trade in these goods was liberalized in 1992.

Aggregate employment for existing EU members and entering CEECs is slated to increase. The CEECs are expected to steadily catch up to wage rates, per capita incomes, and levels of productivity, although less-skilled CEEC workers are not expected to share proportionately in these gains.

Increased flows of capital in the form of direct and portfolio investments into the CEECs will not place upward pressure on interest rates in Western Europe since the magnitude of capital transfers to the east will remain too small, relatively, to wield influence over the price of capital in Western Europe. To the



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east, interest rates stand to fall in most of the CEECs, and the decreasing costs for capital are expected to help foster economic growth in the region generally.

Since trade in goods and services, as well as capital flows, is not likely to lead to an equalization of incomes among the current 15 members of the EU and the CEECs in the short term, gaps in wages between regions are expected to persist for some time. Moreover, as firms and even some CEEC industries are closed and others are expanded with the privatization and restructuring of eastern industry, the EU will be faced with assisting the CEECs through their structural transformations. A special source of funds will be needed to reduce and ameliorate the shocks experienced by individuals and households facing such profound changes.

These changes make it clear that, even with restrictions, labor migration will, over the short

term, have greater effects on the EU's labor markets than will trade and investment. Sharing contiguous borders with some of the CEECs, and in relatively close proximity to others, Austria and Germany can expect to absorb the lion's share of eastern migrants. Of the predicted annual net migration of close to 300,000 workers, 200,000 are expected to head for Germany. But estimates suggest that the number of annual migrants should halve within a decade. Even though fears concerning the scope and scale of migration appear unfounded, measures have nevertheless been introduced to slow the free influx of labor during the first several years following accession. Economic growth, welfare gains, and successful structural changes in the accession countries will eventually raise incomes and improve living standards, thereby lessening pressures that promote migration.

AN INTERVIEW WITH LATVIAN PRESIDENT VAIRA VIKE-FREIBERGA

AS THE EUROPEAN UNION begins to expand eastward, NATO has announced that it will decide next year whether to expand into the former Soviet republics of Latvia, Lithuania, and Estonia. Earlier this year, *Current History* consulting editor Sean Patrick Murphy interviewed visiting Latvian President Vaira Vike-Freiberga in Washington, D.C. about Latvia's possible entry into NATO and the implications for Latvia's relationship with Russia. An edited transcript of the interview follows.

What does Latvia hope to gain by joining NATO? And do you feel the Bush administration is taking the right tack with Russia by asserting, as Secretary of State Colin Powell did, that Russia will not have a veto in determining which countries can join NATO?

Absolutely and resoundingly, "Yes." I think it's the right tack because we are, the three Baltic states, we're sovereign nations, we were held captive, held occupied for a half century. It was an illegal occupation. I just recently again heard voices raised in Russia that we voluntarily joined the Soviet Union, which I think is absolutely appalling. It's an appalling refusal to come to grips with history and to get on with a different perception of what really happened. In other words they haven't renounced communism and the horrors that were perpetrated. I think that's extremely serious. And, with that sort of attitude, I think one has to take a strong stance because we don't want to be going back

to the principles that guided that country when it was the Soviet Union. I think it would be a danger, not just to us in Latvia, but to everybody else in the world.

Do you believe Russia will carry out its threat to consider reopening the question of its borders with the Baltic countries in general and with Lithuania in particular should they become members of NATO?

In our case, Latvia has agreed on a border treaty with Russia in which Latvia has renounced a considerable chunk of its territory. In spite of this concession on Latvia's part, the Russians continue to refuse to sign that border treaty. And it's quite clear that their devout hope has been to make it a barrier to our accession to the European Union first and then to NATO. [However,] it has been made clear to us that the physical demarcation of our frontier is considered sufficient by both the European Union and by NATO.

How do you respond to the threat made by Andrei Nikolaev, the chairman of Russia's Duma defense committee, who this March said that Russia is ready to divert the flow of goods now going through the Baltic states to Finland and to shift energy exports as well if Estonia, Latvia, and Lithuania become members of NATO?

Well, as I say, Russia of course is a sovereign country and has the latitude to do with its goods as it chooses. And if [the Russians] want to cut off their nose to spite their face or to put pressure on Latvia, there's nothing we can do about it. But, if they want to ship their goods at the fastest and the cheapest and most economically rational route, they will continue

THE BALANCE SHEET

From an economic standpoint, eastern enlargement appears to be a win-win situation. CEEC economies are comparatively small, together generating an output that is only 4 percent of the EU-15, and eastern enlargement is not expected to generate significant benefits or costs for Western Europe over the short term. In contrast, the CEECs are expected to gain disproportionately and significantly upon accession.

Friction will occur in the intense power play that will emerge between net payers and net receivers of Brussels's budgetary funds. In addition, the power play could cause the formation of at least two camps firmly at odds with one another. Austria, Germany, Sweden, and the Netherlands apparently will be counting their gains, while France, Spain,

Portugal, Greece, and Ireland will be mourning their losses.

The EU faces the task of implementing major institutional and policy reforms to further prepare itself for eastern enlargement—at least by the time of the next Inter-Governmental Conference that is scheduled for 2004. The conference will allow changes to be made to already existing treaties. The exact procedures and objectives of the 2004 conference will be decided upon in December 2001 at the European Council meeting slated to take place in Laeken, Belgium. If at Laeken the EU's leaders and representatives fail to introduce an agenda with new treaties to be considered at the 2004 conference, frictions between and among EU member nations could emerge and diminish substantially the prospects for a broadly inclusive and speedy CEEC accession process. ■

doing it through the Latvian ports, where the distances are the closest and where the prices are competitive with any harbor in the Baltic Sea and which never freeze over in the winter.

It is estimated that as many as 300,000 Russians live in Latvia without formal citizenship. Under what conditions can Russians apply for citizenship? Do you believe that your government has gone far enough to include these people in Latvian society and politics?

Our constitution guarantees rights to all residents. Anyone residing in Latvia is entitled to all the basic human rights of right of property, right of residence, right of work, freedom of movement, freedom of religion, freedom of association. Any resident of Latvia is guaranteed these rights under the constitution, citizen or noncitizen. The only difference is that, much as it is in many countries, noncitizens cannot vote, they are not drafted into the army, and they cannot take public office.

This February you were quoted as saying that the establishment of friendly relations with Russia must be a key foreign policy priority. How has Latvia ensured that it has remained a priority?

I have repeatedly expressed my readiness for a personal meeting and talks with President Putin. It did take place; we met in Austria. I have expressed my readiness to engage in dialogue with officials from Russia and have done so. We have had on several occasions visits of parliamentarians from the Duma and I have met with them.

The United States Department of State recently issued a report criticizing Latvia for, among other things, poor prison conditions, a weak judicial system, and widespread corruption. Has your government responded to these criticisms?

My government's been working on it for years. [But] our prison system, for instance, is one of the sad inheritances we have from Soviet times. And Lord knows, sitting in a Soviet prison wasn't exactly a piece of cake. Latvia has been investing huge amounts of money in trying to bring the standard of living in our prisons to some kind of more humane level. We are grateful for the collaboration we have had from other friendly countries and from the Soros Foundation. . . . I think that when we join the European Union we will have to answer to the standards required by the European Union—so many square meters per prisoner and so on. This will require very heavy investments; it's going to be very costly for the Latvian government to bring these up to standard.

Corruption is a widespread phenomenon in all postcommunist countries, including ours. We are fighting—the public is becoming increasingly aware of the problem and there is widespread discussion in public about it.

There are those who say the Baltics are the East of the West, while Russia has traditionally viewed them as the West of the East. Where do Latvia and the other Baltic nations belong in your view?

I think that they belong to where they've been historically, for 800 years and more. And that means with the rest of Europe. ■