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On 12–13 December 2002, at the European Council in Copenhagen, the accession negotiations between the European Union (EU) and ten candidate countries (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia) were officially concluded. Subject to ratification of the accession treaty by member states and the acceding countries, these ten countries will become members of the EU on 1 May 2004. This is by far the largest expansion the EU has witnessed in its almost fifty years of existence, both in terms of the number of countries and languages involved and in terms of their area and population as well.¹ Moreover the accession countries are very diverse themselves, ranging from the small, services-oriented Mediterranean islands of Cyprus and Malta to the much larger, but still more agricultural, Poland. Last, but not least, the 2004 enlargement will make the EU more diverse in another very important category: per capita income. On average, the future members' GDP per capita is less than half the GDP per capita of the existing members (in purchasing-power terms). For comparison, when Spain and Portugal joined the EU in 1986, their average GDP per capita was about 70 percent of that of the existing EU countries (in purchasing-power terms).

For many observers (and, obviously, EU officials) the present enlargement is a reaffirmation of the underlying ideals, values, and objectives of the EU. Among the EU's stated objectives is the encouragement of peace, stability, democracy, and prosperity throughout Europe. It has been argued that enlargement will prove to be instrumental in the achievement of these objectives by ending the artificial divide between Western and Central and Eastern Europe through the promotion of economic and political integration. Yet despite the many years of preparation, and the considerable efforts made by officials of the EU and member states in advertising the benefits of enlargement, the public's

uncertainty or even hostility, in both member and acceding countries, in regard to this European project remains strong.² It thus came as no surprise that the enlargement-related financing package remained a bone of contention between the candidates and the EU until the very end of the negotiations. Member and candidate country governments were worried that their parliaments and electorates could either delay or derail the enlargement process if they deemed the “costs” of enlargement to be excessive. The compromise reached in Copenhagen provides for financial aid to the accession countries under the current budget (which runs until the end of 2006) of a maximum of \$40.85 billion for 2004–2006. This includes money for agricultural subsidies, infrastructure spending, regional aid, and funds to help improve nuclear safety, public administration, and border protection. The new members will also have to make contributions to the EU budget, however, amounting to about \$15 billion for 2004–2006. Moreover, they may not be able to appropriate all the money that has been allocated to them in the budget by 2006. As a result, the commission estimates that the net budget-related cost of enlargement will amount to less than one-thousandth of EU GDP. This appears to be a small price to pay for European unity.

Nevertheless, enlargement may entail costs beyond its immediate budgetary implications by blocking reforms that are long overdue. An illustrative example of this is the so-called Franco-German compromise on the basis of which the Council in Brussels in October 2002 set the level of resources for the Common Agricultural Policy (CAP) up to 2013. The compromise shied away from expenditure cuts, all but ensured that the present beneficiaries of the CAP will continue to receive transfers at current levels, and made sure that CAP principles (including the controversial issue of direct payments) are fully extended to the new members. This decision paved the way for the acceptance of the overall financing package for enlargement within the EU. But it also implies that future reforms of the CAP will reflect the interests of both present and new members, with uncertain consequences for the likelihood of a fundamental overhaul of the EU’s agricultural policies.

The example of the CAP invites the question of just how well the EU is prepared to manage enlargement—the question at the core of the chapters in this book. Richard E. Baldwin (chapter 2), in a thought-provoking overview surveying some of the most pressing issues of EU enlargement, discusses the CAP and a number of other key challenges

brought about by the “big-bang” expansion of 2004. An important part of his analysis focuses on the reform of the policymaking mechanisms of the EU in the Treaty of Nice. Without much doubt, the EU’s traditional, consensus-based approach needed streamlining, even before the dramatic increase in membership that enlargement will bring about. But Baldwin argues that the new procedures put in place by the Nice Treaty might be too complicated to deliver the decision-making efficiency needed to ensure that the EU can handle the vast task of managing enlargement.

1.1 Monetary Policy

Efficiency of decision-making is also a focal point in chapter 3 by Helge Berger, Jakob de Haan, and Robert Inklaar, who set their sights on the implications enlargement has for the European Central Bank (ECB). Within less than a decade, the number of member countries in the euro area could more than double, with the vast majority of accession countries being relatively small in economic terms, compared with current members. Absent reforms, such a significant but asymmetric expansion could impede the effectiveness of monetary policymaking. Moreover, the possible over-representation of small member countries on the ECB Council poses a risk that monetary policy could deviate from the targets specified in the Maastricht Treaty. The chapter illustrates these issues, describes the principles on which reforms of the ECB statute could build, and discusses specific institutional reform scenarios, including the recent ECB proposal. A key result is that, although centralization might be a “first-best” solution in many ways, it has possible disadvantages from a political-economy perspective, including a potential conflict with the established voting rights of current euro area member countries.

Alex Cukierman, in his comments on chapter 3, also sides with the idea put forward by Berger, de Haan, and Inklaar to aim at an overall Council size of about fifteen members (the ECB proposal suggests a Council of twenty) and to introduce an asymmetric rotation scheme to better reflect member countries’ size and other economic characteristics. He cautions, however, that any such scheme must be flexible enough to accommodate changes, as enlargement itself would likely alter the fundamental behavior of many of the acceding economies. Cukierman concludes his discussion with a warning. As his research suggests that the link between central bank independence and

disinflation in transition economies could be weak, too much emphasis on output stabilization after enlargement may raise the inflation bias in the euro area. He suggests that, rather than overburdening the ECB, other policy instruments should be charged with stabilizing real activity.

Continuing to focus on monetary policy, Daniel Gros (chapter 4) asks whether the accession countries would be well advised to fix their national currency to the euro prior to joining the currency union. It is well known that countries with high public debt—taken, in Gros’s approach, to be synonymous with weak fiscal institutions—might benefit from such an external anchor. Chapter 4 argues, however, that the relationship between the strength of a country’s domestic fiscal framework and its incentive to peg to the euro might be non-monotonic: Whereas countries with very high and very low debt levels will clearly profit from an external anchor, countries with moderate levels of public debt will generally have a stronger incentive to keep an independent national monetary policy, because countries with moderate debt levels require only some seigniorage revenue to supplement the government budget and might find the resulting equilibrium inflation still tolerable. In contrast, inflation would be too high in high-debt countries in the absence of a peg, and low-debt countries lack the incentive for raising seigniorage in the first place. Applied to the enlargement process, this implies that both countries with very strong and those with very weak fiscal institutions or debt levels might have an interest in joining the euro area quickly. For instance, the choices of Estonia (very strong) and Bulgaria (very weak) to adopt the euro/deutsche mark via currency boards could be interpreted as reflecting these considerations.

Margarita Katsimi’s comments on chapter 4 take issue with two critical features of the Gros approach. On an institutional level, Katsimi argues that the setup of Gros’s model neglects the time inconsistency problem related to seigniorage creation: Were money demand to depend negatively on inflation, the inability of the government to commit to not raising seigniorage would lead to a second inflationary bias. A second issue highlighted in Katsimi’s comments is Gros’s assumption in the chapter that weak fiscal institutions are not reflected in a country’s budget constraint. Changing this assumption could leave countries with higher debt levels and weak fiscal institutions worse off after delegating monetary policy to the ECB because, although the fiscal inefficiency would continue to create a need for higher fiscal revenue, no more seigniorage income would be forthcoming.

1.2 Factor Mobility

The issue of the free movement of persons occupies center stage in the negotiations on EU enlargement—not least because of widespread public fear of a massive influx of Central and Eastern European labor into current member countries. The EU Commission and several studies have reviewed the pros and cons of alternative flexible transitional-arrangement proposals, ranging from the current bilateral guest worker arrangements used by some EU members to the establishment of fixed quotas during a limited period of time. But just how large is the potential for migration really? Chapter 5 by Michael C. Burda takes a fresh look at this issue, by adopting an efficiency perspective in the study of economic integration—that is, how would a social planner allocate capital and labor in two regions to maximize national output net of migration and investment costs? Burda stresses the importance of adjustment costs in determining the speed of efficient economic integration, as well as the interpretation of differences in factor returns across regions during the adjustment to the steady state. A significant implication of Burda's analysis is that if costs of adjustment are important, the fact that wages in some of the future members are far lower than in the EU provides no information about the extent of (efficient) economic integration. A corollary of this is that the currently observed large differences in factor rewards between the EU and the future members do not necessarily imply massive migration flows if the forthcoming changes in the institutional framework (e.g., adoption of the EU legal framework for capital ownership, elimination of capital controls, and the likely introduction of the euro in the acceding countries) make capital more mobile than labor.

Carlo Perroni, in his comments on chapter 5, initially draws attention to two issues that Burda's analysis abstracts from, namely, the importance of fixed factors of production and of agglomeration effects. Neither of these issues, however, would be expected to alter the chapter's conclusions with respect to long-run outcomes—they could even strengthen the model's main results. For example, Perroni notes that agglomeration effects might make long-run allocations more sensitive in the sense that very small changes in adjustment costs could lead to drastically different outcomes. All in all, Perroni concludes that economic policymakers may have every reason to take a close look at adjustment costs as one of the more important forces shaping factor migration in an enlarged EU. He also argues that, if the model were

based on a set of somewhat more realistic assumptions, there might be more scope for policy intervention after enlargement than Burda seems to suggest.

Turning from emigration potential to immigration policy, chapter 6, by Jaime de Melo, Florence Miguet, and Tobias Müller, recounts the Swiss experience with immigration and draws on the unique direct-democracy setting Switzerland presents to bypass the problem of “hypothetical bias” plaguing the analysis of conventional survey data. The authors first draw out the political-economy implications of immigration policy within the context of the median-voter model. Under various assumptions about economic structure, they show that the evolution of immigration policy in the Swiss case can be explained as the outcome of majority voting by self-interested individuals who face different voting costs. In the empirical part of the chapter, the authors present an ingenious approach to analyzing the determinants of voters’ attitudes toward immigration. To this purpose they use data drawn from an individual-level survey carried out two weeks after the Swiss referendum in September 2000 on a popular initiative asking for a limitation on the number of foreigners at less than their existing share of the Swiss population. The popular initiative was rejected by almost two-thirds of all voters even though survey data suggested that only a slim majority opposed it. The authors explain this startling result by appealing to differences in observed and unobserved characteristics between those who voted and those who did not. They conclude that opinion polls are likely to suffer from hypothetical bias and thus may be an unwise guide to policy regarding immigration.

In his comments on chapter 6, Riccardo Faini initially notes that the gap found by de Melo, Miguet, and Müller between Swiss voters’ attitudes toward migration and the stance of Switzerland’s migration policies has been a feature of migration policies since at least 1880: Migration policies have by and large been more liberal than warranted by voters’ attitudes and interests. Faini also draws attention to what he considers to be a shortcoming shared by the chapter and the political-economy literature on migration policy, namely, the lack of a joint analysis of trade and migration policies. He argues that the fact that the Swiss data used by the authors refer only to migration and do not capture the effects of time-varying factors such as the evolution of the real exchange rate and trade policies may be responsible for the chapter’s finding that observed characteristics, such as income and education, play only a minor role in determining voter attitudes.

1.3 The Motives (and Consequences) of Enlargement

Chapter 7 by Ben J. Heijdra, Christian Keuschnigg, and Wilhelm Kohler presents a thorough attempt at establishing the importance of different channels through which enlargement can affect the incumbent EU member countries. The main innovation of the chapter is that the authors combine a search-theoretic framework of job creation and destruction with an overlapping-generations model of household behavior and capital accumulation to address how commodity market integration, budgetary effects, and, notably, immigration can affect investment, unemployment, and welfare in the member states. The quantitative importance of their main theoretical results is then examined via a multisector dynamic applied general equilibrium model for the German economy, which they take as an example. An important finding is that if the economy faces some degree of wage rigidity, goods market integration yields further welfare gains beyond those traditionally assumed, because integration leads to lower capital and intermediate-goods prices, thus increasing the capital intensity of production and inducing firms to post more vacancies. The resulting decrease in unemployment yields a “fiscal dividend” that is larger than the increase in the net contributions to the EU budget that Germany has to face.

In his comments on chapter 7, Sascha O. Becker commends Heijdra, Keuschnigg, and Kohler for explicitly introducing unemployment into their model but questions whether the search model they employ explains a significant part of German unemployment. He notes that the institutional framework of powerful unions in Germany creates a situation of quasi–minimum wages, thereby making it less likely that unskilled workers in Germany will face a significant drop in their real wages as a result of migration induced by enlargement. Becker also points out that the authors assume that the budgetary costs of enlargement will be exclusively financed by a cut in the Regional and Structural Funds given to incumbent countries. Alternatively, one could assume increased contributions to the EU budget or cuts in the common agricultural policy funds, either of which might lead to smaller net benefits of enlargement for Germany.

Chapter 8 by Arjan M. Lejour, Ruud A. de Mooij, and Richard Nahuis provides an assessment of the economic costs and benefits of enlargement using WorldScan, a computable general equilibrium (CGE) model of the world economy. Unlike many previous studies

that model accession to the internal market as a simple across-the-board reduction in trade costs, chapter 8 estimates gravity equations to derive more-precise estimates of the reduction in the barriers to trade for sixteen different industries. To calibrate the aggregate impact of enlargement, the chapter looks at three dimensions of enlargement: the move toward a customs union, the enlargement of the internal market, and the free movement of labor. The CGE simulations suggest that the aggregate impact of enlargement will involve large gains for the Central and Eastern European Countries (CEECs) and a modest welfare improvement for the EU. Their study also suggests that among the three dimensions of enlargement they examine, it is the accession to the internal market that yields the largest economic effects. Moreover, accession to the internal market has a positive impact for both the EU and the CEECs, although both the benefits and the changes in the allocation of production across sectors are much higher for the acceding countries than for the current members. In contrast, migration is found to produce adverse distributional effects for low-skilled workers in the EU; these effects tend to be more pronounced in the northern than in the southern EU countries.

In her comments on chapter 8, Rajshri Jayaraman commends Lejour, de Mooij, and Nahuis for providing a detailed sectoral analysis of the effects of EU enlargement, facilitated mainly by their attempt to estimate sectoral variations in the expected reduction of trade costs. She notes, however, that the chapter could have profited from additional sensitivity testing, even though such testing might have been difficult to square with the very detailed analysis undertaken by the chapter's authors. Concluding, Jayaraman points out that the finding that the CEECs will face small losses from labor migration may be due to the fact that the chapter does not capture the effects of remittances that the immigrants might be sending back to their country of origin.

In chapter 9, Antonis Adam and Thomas Moutos argue that strong political-economy forces could have been behind the big-bang approach to EU enlargement. They construct a simple model to show that, if trade involves the exchange of vertically differentiated products, the effects of enlargement on the EU's incumbent members can be asymmetric. One country may enjoy increased access to the joining country's market without having to face a displacement of domestic production by imports, whereas another may have to face increased import penetration. They demonstrate that producers in low-income (and technologically lagging) incumbent countries such as Greece

would prefer that enlargement be directed toward technologically advanced countries (e.g., Japan), which have comparative advantage in producing high-quality varieties of differentiated products. By the same token, the opposite is true for high-income incumbent countries such as Germany. The authors then proceed to present evidence—based on the analysis of unit value data for about 1,500 products—supporting their assumptions regarding the relative position of individual EU countries, the CEECs, and Japan on the quality ladder. They also present econometric evidence showing that previous EU enlargements had asymmetric effects on incumbent members, in accordance with the predictions of their theoretical framework.

In his comments on chapter 9, Ronald W. Jones notes that the asymmetry identified in chapter 9 is a quite general underlying question in the theory of international trade: Is (beneficial) international trade encouraged more in a group of countries that are dissimilar in their factor endowments and technology or in a group of countries that are fairly similar in these characteristics? Jones also draws attention to the fact that the widely observed fragmentation of vertically integrated production processes implies that firms can reap gains by locating, say, the more labor-intensive segments of a production process in the low-wage CEECs, even if the final emerging consumer good (which is the focus of the chapter) is of high quality and would, without such fragmentation, be produced entirely in the high-income country in the EU. The extent to which EU enlargement facilitates further fragmentation of production activities implies that the asymmetry of effects identified in the theoretical part of the chapter may not survive in more detailed settings.

What have we learned? Although the chapters and comments presented in this volume point to a variety of issues deserving the attention of practitioners, policymakers, and academics alike, perhaps the most important lesson is that, this time around, EU enlargement is not just incremental, but really a big bang. The sheer scale of the 2004 enlargement effort has a number of significant consequences along many dimensions, ranging from the intercountry and intracountry distribution of benefits and costs, to issues of monetary management and migration flows, to the fundamental subject of decision making in an enlarged EU and euro area. By describing the more important challenges involved and pinpointing some possible strategies for meeting them, the volume provides useful guidance in shaping policies that will provide a secure underpinning to Europe's future.

Notes

The views expressed in this introduction are those of the authors and should not be interpreted as those of the International Monetary Fund or of the Athens University of Economics and Business.

1. Strictly speaking, the adjective “largest” pertains to the *absolute* increase. In *relative* terms, the increase in population (20 percent) and area (23 percent) resulting from the 2004 enlargement is somewhat less outstanding. The enlargement in 1973 (Britain, Denmark, Ireland) was proportionally larger in terms of population, whereas the enlargement in 1995 (Austria, Finland, Sweden) was proportionally larger in terms of land area involved.

2. Within current EU countries, on average, 66 percent of the respondents to polls are in favor of the enlargement of the EU, whereas 21 percent oppose it (European Commission 2002). The highest approval rates are registered in Italy, Ireland, and Spain (82, 79, and 73 percent, respectively), whereas the largest opposition to enlargement is found in Austria, Sweden, and Finland (32, 28, and 27 percent approval, respectively). Among the future member states, survey results (European Commission 2002) indicate that on average 52 percent of the respondents regard EU membership as “a good thing,” and that 61 percent would vote “yes” in a referendum on EU membership. Hungary and Slovakia register the highest support for EU membership (77 and 69 percent, respectively, would vote “yes” in a referendum), whereas those surveyed in Estonia and Latvia seem least supportive (with rates of 39 and 45 percent, respectively). At the time of writing, the first referendum on EU membership had already taken place in Malta, with a result in favor of EU membership.

Reference

European Commission. 2002. “Candidate Countries Eurobarometer.” November. Brussels.