THE ECONOMIC IMPACT OF ENLARGEMENT TO DATE

Maurice Guyader*

The European Union is now unifying Europe after decades of conflicts. The EU has enlarged to 25 and soon 27 Member States. Over the last fifteen years, the EU has helped to transform Central and Eastern Europe into democracies. It has also inspired reforms in Turkey, Croatia and the other Western Balkans countries. Europeans benefit from having stable democracies and prosperous market economies. The enlargement process extends peace, stability, security, human rights, democracy, the rule of law and prosperity.

Two years after May 2004 the biggest enlargement ever of the European Union is an economic success: the 10 new Member States' economies are growing at a rapid pace enabling them to progressively bridge the gap with their neighbours. But the latter also win as the increase of the EU's single market by 75 million to 450 million inhabitants brings a wealth of trade and investment opportunities.

The fifth enlargement did not involve, as some feared, any major disruption to the economic stability of the continent, nor an uncontrollable flow of population away from the east of Europe towards the west of the continent.

On the contrary it permitted the very rapid integration of the new Member States into the European Union trade flows and has created conditions favourable to sustained growth in Central and Eastern Europe. This should in turn lead, in the near future, to some convergence of these economies with those of Western Europe.

Intensifying commercial links, trade liberalisation through the Europe agreements signed in the early 90s, foreign direct investment, greater efficiency through adapting market mechanisms, macro-economic stability are behind the good results.

*Maurice Guyader is a principal administrator in the European Commission, he is also associate professor at Paris III Sorbonne Nouvelle University. The views expressed in this paper are the authors' alone and should not be attributed to the European Commission, even if many of them are partially the results of studies which have been done by economists working in the different services of the Commission.

Overall, the fifth enlargement, by leading to a larger, more integrated internal market, has created the conditions for the whole European economy to become stronger and more dynamic, hence to be better equipped to face increased global competition.

It is possible to say that the fifth enlargement has been a success for all its Member States.

We will examine the results of this success in pure economic terms, as well as on industrial matters. There are also positive results in the social domain at costs which are sustainable. We will end this short paper by a rapid survey of the current perspectives of the enlargement policy.

An Economic and Industrial success

Enlargement is a catching—up and economic growth tool

Additional growth because of enlargement is estimated to1.5%/2%a year in the new Member States. In the old Member States, the former eastern border benefit most from the enhanced trade and investment possibilities (mainly in Germany, Austria, Italy, Denmark).

In comparison with the previous EU15, enlargement increased income diversity but in 2005, per capita income is already at 43 % of the former EU15 in Latvia, 46 % in Poland, 75 % in Slovenia and *77 %* in Cyprus.

The central and eastern European countries have already successfully transformed their economies from central planning to functioning free markets, even before enlargement. Their ambition of complying with the Copenhagen criteria for EU accession had served as a catalyst for change.

Per capita incomes are much closer to former EU15 levels now than they were back in 1997 (the year of Agenda 2000). Recently EU-10 growth has been higher than in the former EU15 and EU-10 are now on a long way to convergence with theEU-15.

Macro-economic indicators are generally making improvements in the New Member States Trade integration which started long before accession and capital movements that were liberalised before accession are amongst the main factors which helped in this process and have played a decisive role in catching up. The

Euro adaptation envisaged can create a new focal point for further structural reforms while providing for macro-economic and fiscal discipline.

Regarding the Maastricht criteria, inflation in the EU-10 has gone down, but wage pressures remain strong and interest rates have come closer to the EU-15 levels over recent years. Eight of the EU-10 have public debt ratios which were in 2004 below the 60% of GDP, half of the new Member States were below the Maastricht threshold of 3 % of GDP for fiscal deficit and 7/10 already joined the exchange rates mechanism. The current account deficits of the EU-10 have been financed by foreign direct investment so far.

The average unemployment rate for the EU-10 slightly decreased over 2004-2005 and employment growth accelerated in the EU-15 over the past two years. Trade integration is already a reality in the global EU 25.

The 10 new EU member states have been highly active participants in the process of trade integration since the early 1990s. This integration process is being driven by trade liberalisation policies, falling transportation and communication costs, rising income levels and development of increasingly global production systems.

Trade flows between the EU-10 and the EU 15 increased dramatically in the period preceding EU accession. Both the prospect of EU accession and trade liberalisation through the Europe agreements triggered a surge in trade in the second half of the 1990s. As a result of the Europe agreements the EU-15 rapidly became the major trading partner for EU-10 countries. In average, the EU-15 has a surplus of more than Eur. 14bn with the 10 Central and Eastern European acceding Countries between 1993 and 2003. The degree of trade integration of the recently acceded Member States with the EU-15 slightly exceeded the degree of the EU-15 countries.

EU accession boosted exports of goods in the two groups of countries. Over the period 1993/2003, the EU-10 increased its market share in the EU-15 by 8 percentage points accounting for 13% of the extra EU-15 imports of goods. The EU-15 countries accounted for around 70 % of the extra EU-10 imports of goods in 2005 with Germany remaining the top EU-15 exporter to these countries. There is a certain complimentarity between the trade structures of the EU-10 and EU-15.

There is a strong growth of Foreign Direct Investment (FDI) in The New Member States

We have recently seen a rapid growth of foreign direct investment flows into the new Member States. In 2004 the global stock of FDI reached 200 billion EUROS in the new Member States (starting at more or less zero at the beginning of the 1990s). The three largest economies: Poland, Hungary and the Czech Republic absorbed more or less 80% of this sum. The EU-15 is by far the main investor, with a share of more than three-quarters of the total inward stock in the new Member States in 2004. The Netherlands, Germany and France are the most important investors. Inward FDI is modern and more skill intensive sectors have increased more rapidly. Transport equipment is the largest sector in terms of FDI in manufacturing in the new Member States.

The sensitive question of possible relocation of industries in the new Member States must be well understood. Studies confirm that relocation of companies from the former EU 15 to the new Member States remains a marginal phenomenon. Moreover, Central and Eastern Europe is not the main destination for relocation. It is not enlargement that mainly causes outsourcing and relocation, but global competition.

Companies will always seek lower costs, larger markets, technological innovation and other factors that give them a competitive edge. European companies face global competition. Investing in Central and Eastern Europe can help European industry to maintain jobs and create growth throughout Europe. For instance, the expansion of service enterprises is creating jobs both in new Member States and former EU 15. Enlargement helps the EU to meet the challenge of globalisation by increasing internal and external trade and thus keeping and creating jobs.

The EU accession culminated a process of gradual structural transformation of the new Member States. The new Member States are particularly attractive, but we cannot say that the direct increasing foreign investment flows from the EU-15 to the new Member States are perfect indicators of possible relocation of activities from EU-15 to EU-10 by far. Not all FDI can be associated with the shifting of activities from EU-15 to EU-10.

An important aspect from this problematic is the fact that the trade in intermediate goods has become the most important component for the new Member States (it represents on average around *7%* of their GDP). Supplying local markets in service trades is the principal motivation for foreign investors rather than outstanding or establishment or export-oriented activities.

The concerns raised among the old Member States due to fears of loss of employment seem to be exaggerated. While intra-EU relocations may have a significant impact in certain sectors like textiles, transport material and information and communication technology for certain EU-15 regions where they were concentrated, there are no reasons to believe that a massive shift of activities and jobs from the old to the new Member States is underway. The EU-15 remains by far the largest host for FDI within the enlarged EU. In 2003 the share of the new Member States in the outflows of the EU-15 was only 1,5%, while close to two-thirds went to the EU-15. Only a very small share of FDI by the EU-15 firms going to the new Member States involves the substitution of activities previously carried out in the home country. Estimated relocations represented less than 10% of the total French foreign direct investment in central and Eastern European countries.

Positive results in the social domain at sustainable costs

The impact of Enlargement on labour markets of the former EU 15 is limited and social dumping is not a reality

The impact of relocations on employment levels in the EU-15 economies also appears to be clearly limited. The effect of employment substitution between home employment in European multinationals and employment created in their subsidiaries in the new Member States also tends to be small. The employment creation effect in subsidiaries in the new Member States is considerably greater than the employment reduction at home. But the skill composition of labour demand in the EU-15 may change as a result of intra-EU relocations. In Germany it has contributed to the fall in the relative employment of manual workers.

The question of potential migrations from New Member States to the former EU 15 must not be over-estimated.

The doomsday predictions of a flood of workers from Central and Eastern Europe have proved to be unfounded. Labour migration from new Member Sates to former EU 15 has been modest, rarely reaching even 1 % of the active working population of the host country. This is the case both in those Member States that applied restrictions to access to their labour market and in those which did not. These workers have helped to ease labour shortage in sectors such as agriculture and construction.

The very long run migration potential for the EU of the source populations of the Central and Eastern Europe on countries is estimated at around 3 million people (in cumulated terms over 15 years). These numbers shouldn't affect the EU labour market in general.

Since enlargement there has been an increase in the number of Central and Eastern European countries workers in EU-15 Member States but the number of permits of employment is rather limited. There was an increase in the UK and to a certain extent in Austria and Ireland. A little more than 400 000 Poles migrated in the first year of which 350 000 were seasonal workers. In less than two years 350 000 workers from the new Member States were registered in the UK and close to 150 000 in Ireland.

Ireland, the UK and Sweden have successfully opened their labour markets to the workers from Eastern and Central Europe right from the start, on 1 May 2004. In Ireland, the arrival of workers form the new Member States has played a major role in sustaining the country's high growth rate. In the UK, workers from the new Member States have helped to fill a part of the half a million job vacancies. In light of these positive experiences, Finland, Portugal and Spain have now decided that they too will open their labour markets. Other countries such as Belgium and France have opted for partial opening.

There is no evidence that migration flows from the Central and Eastern European countries caused significant labour market disturbances in the EU15 countries and migration from third countries is a much more important phenomenon than intra EU mobility. A rather high percentage of potential migrations could be classified as highly skilled comprising managers, scientist researchers and students. An important part of this population is students from Central and Eastern Europe receiving tertiary education in countries of the EU-15.

Employment grew 1 % on average in 2005 both in new Member States and former EU 15. Enlargement favours legal migration, which is easier to control, whereas the real problem in many Member States is illegal migration, mainly from third countries.

Enlargement has not undermined labour conditions and led to social dumping. By opening up opportunities for legal work in the former EU 15 the 2004 enlargement has helped to reduce the grey economy (and the black labour market). Legal workers are less prone to exploitation and poor standards; they also pay taxes and social security contributions.

The increase in the registered working population from new Member States in the former EU 15 had no relevant impact in social security spending.

Meanwhile, the EU requires the new members to adopt its health, safety and other labour standards, improving working conditions for people in those countries and contributing to fair competition between companies. There is no evidence that enlargement has caused social dumping. On the contrary, through enlargement, harmonised social standards are slowly but surely spreading across the EU.

Student exchange programmes are a visible political initiative and a very important benefit for all Europe.

The exchange programmes for young people and students are among the most visible political initiatives and the most promising in terms of the furthering of European integration. Among them, the most significant are Erasmus and Léonardo da Vinci. Within the framework of the enlargement policy, they were incorporated very early into the pre-accession process.

From 1998/99 to 2003/04 the ten new Member States had almost 75000 students receiving Erasmus grants, with a constant progression (from less than 5000 the first year to almost 20000 in 2004). Among them, Poland passed from 1400 students in 1998/99 to 6300 in 2003/04, to a total of almost 24.000 students.

The favourable results of this policy should not, however, be appreciated only by quantification of the number of grants allocated by country, but also by the fact that the students of the European Union increasingly requested to go to carry out at least a six-month study period in one of the new Member States. Thus, while in 1998/99 the Czech Republic and Poland had attracted slightly more than 200 students each, in 2003/04 Poland received about 4.500 and the Czech Republic roughly 4.200. This favourable development is noted, on a lesser scale, given the size of the countries, in all the new Member States.

This involves, therefore, fantastic mixing of young people between the 25 Member States of the European Union which shows the major success of this policy, while, few years before, the exchange was completely pointless. Although formally independent of the enlargement policy of the European Union, this policy can, to a rather large extent, be given credit for this development. The other programmes of the Union (of which Léonardo da Vinci, etc) have experienced comparable developments.

The impact of enlargement on agriculture in the new Member States is significative (mainly through financial transfers).

The enlargement to Central and Eastern Europe was widely expected to have considerable impacts on agriculture in both the old Member States and the new ones.

Agricultural employment is shrinking in both old and new Member States, but at a rate around 2 % a year in the old Member States and around 4 % in the new ones.

Association agreements and further bilateral agreements paved the way for a gradual liberalisation of trade on agricultural products. Farmers in the new Member States have received direct payments from the first year as members of the EU at a rate of 25 % of the EU level (plus a possible topping up of 5 % or 10 %) with a possibility of a simplified way of application. Accession led to a dramatic increase of average real agricultural incomes in EU10 in 2004/2005 by more than 70 % as compared to the average between 1999 and 2003 (farm incomes almost doubled in Poland) even if the absolute average income is still in the new Member States far below the level in EU-15. This increase has been caused mainly by the introduction of the direct payments but it may be a certain handicap for necessary restructuring. Fears that EU-15 farmers could suffer from new competitors in the EU-10 have not been confirmed.

The accession to the EU and the implementation of the Common Agriculture Policy has also affected the food processing sector (especially in fulfilling EU hygiene and quality standards) Food processing in the new Member States benefited particularly from foreign direct investment in the years preceding accession.

Total agricultural trade of the EU-10 has been steadily increasing in recent years. It almost doubled but imports have increased slightly more strongly than exports and thus, the agricultural trade deficit of the new Member States with the

EU15 has also increased (except for Hungary). The share of processed products in EU10 exports increased.

The Financial Assistance at a sustainable cost helped the new Member States to implement the acquis.

New Member States have made rapid progress in implementing the EU acquis in national legislation. They have been obliged to fully implement EU legislation. For nearly 99 % of all that had to be implemented, national measures for their implementation had been notified. It is slightly above the average for all Member States. The new Member States are performing substantially better that the former EU 15 in applying EU laws.

By opening up a market of 75 million consumers to companies from the former EU 15 enlargement has strengthened competition in the internal market, which in turn also makes European companies more competitive on world markets. The same rule on internal market, competition and state aid now apply across the 25 Member States. But the cost of compliance with the acquis is considerable (in environment, infrastructure and transport). For environment it can be between 1 and 3% of GDP over an extended time period. The total could be in environment around 100 billion Euros.

In 2005 the financial assistance to the new Member States was a bit more than 2% of their GDP (only 0.1% of GDP in the former EU 15). A part of the costs comes back because the people in the new Member States buy most of their imported goods from the former EU 15. The disbursements equal not less than *7* % of the EU budget.

The new members' share of the Union's budget represents only 0.15 % of the gross domestic product. This money is mainly spent on better infrastructure, which benefits businesses across the whole EU. Moreover, the new member economies are growing twice as fast as the old ones. The money spent to help developing these economies creates new business opportunities in old and new Member States alike.

Under the proposed financial perspectives 2007/15 net EU transfers to all new Member States together, would vary from some 1,6% to 3,3 % of their aggregated GDP with the smaller net transfers observed at the beginning of the period.

Poorer countries are expected to receive more. Bulgaria, Lithuania, Latvia and Romania are going to receive a net inflow of EU transfers close to 4% of GDP.

Current Perspectives of the Enlargement Policy

Before ending this short presentation on the economic impact of the fifth enlargement, we should like to draw very quickly what are the economic perspectives of the enlargement policy in the relations with other countries in Europe.

Bulgaria and Romania will enter in 2007 or 2008, once they meet the criteria. Croatia will follow some time later, once it fulfils all the conditions. Other countries of the Western Balkans have the perspective of eventual accession, but they have major work to do and will only be able to join once they are fully prepared. Turkey is negotiating accession with the EU, but it will take a long time to meet all the criteria - perhaps a decade or more. Any decision on the accession of a country has to be taken unanimously by all Member States.

In this framework we have to take into account the concept of absorption capacity, which is about whether the EU can take in new members while continuing to function effectively. It is a functional concept, not a geographical one.

Absorption capacity is an important consideration, as stated by the European Council in Copenhagen in 1993: "the Union's capacity to absorb new members, while maintaining the momentum of European integration, is an important consideration in the general interest of both the Union and the candidate countries". The question of absorption capacity was dealt with for the 2004 enlargement by the Commission's Agenda 2000 document (produced in 1997), which proposed reforms of institutions, policies and the budget of the EU. It paved the way for the decisions in 1999-2003 that prepared the Union for a smooth accession of the 10 new member states in May 2004.

On the other side the EU Treaty says that any European country which respects the values of democracy, human rights and the rule of law may apply for EU membership. However, this does not mean that all European countries must apply, or that the EU has to accept all applications. It is not an automatic process, but one where conditionality is the key. The EU's borders are defined by decisions taken unanimously at the highest political level.

The EU is based more on values and political will than on rivers and mountains. The European Union is a political project, and its borders are political. They differ from physical and geographical concepts of Europe. Geographers and historians have never agreed on the physical or natural borders of Europe. The political border of the EU has changed every time a new country has joined.

For the time being our commitments concern Bulgaria, Romania, Turkey, Croatia and the other Western Balkans countries, if we consider the question of comparison between Ukraine and Turkey, they are at different stages in their relationship with the EU. Turkey's membership prospects and European vocation are long-standing, while Ukraine's EU aspiration is very recent.

The EU supports Ukraine's quest for democratic stability and economic development through the European Neighbourhood Policy. It paves the way for free trade, economic assistance, enhanced political dialogue and better people-to-people contacts. The EU has never offered a membership perspective to Ukraine, and any such decision would have to be taken unanimously by all member states.

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The fifth enlargement has acted as a catalyst of economic dynamism and modernisation for the European Union, helping the economies of former EU 15 and new Member States to better face the challenges of globalisation. At the same time, the economic changes induced by this enlargement have been absorbed quite smoothly, and there is no evidence of disruptive impacts on the product or labour market. Careful preparation of the enlargement over the previous decade has been a key to achieve this successful outcome.

The citizens of the EU 25 benefit from the increased stability and peaceful development to which the enlargement of the EU has contributed. The citizens of the former EU 15 benefit from rising consumer demand in the new members because companies have sold their goods, services and know-how in these markets, which has helped to keep and create jobs back home. Each machine sold by a German company in Poland benefits German citizens, while each French car sold or transaction carried out by a Dutch bank in the new member states benefits the French and Dutch economies. Trade between the former EU 15 and the new members has quadrupled in volume in the last decade. The former EU 15 have long enjoyed a major trade surplus with the new member states, which has helped to maintain jobs.

Citizens can benefit from enlargement in other ways, such as by easier travel, better chances to study abroad, and better business conditions.

When the EU structural funds finance highways and bridges in Spain and Portugal, or in Poland, Estonia and Slovenia, all Europeans travelling, living or doing business in those countries benefit from enlargement.

In a world marked by global competition economic dynamism is essential. The fifth enlargement has offered new opportunities for all the new Member States to undertake important steps in this direction. Both companies and consumers will benefit from a larger internal market, technological innovation, lower prices, and hence will be in a better position to fully reap the opportunities of the new division of labour that is emerging at global level. The Lisbon strategy for growth and jobs and the path to the euro offer a framework in which to pursue the necessary structural change. Taking with determination this road leading to a dynamic European Union on the world scene will yield further substantial benefits to all parties involved in the EU and beyond.