The EU and the countries of Central and Eastern Europe
The economy of the accession

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Abstract
The aim of this paper is to examine the impact of the accession of CEE countries in the EU. In this context, it is important first of all to chart the ways in which accessions have changed the 'weight' and role of the EU in the GPE on previous occasions. Clearly, for the EC/EU itself, the expansion of its economic and commercial 'space' has created institutional and other stresses, often revolving around the allocation of resources and the maintenance of various political-economic 'bargains'. From the outset, there has also been a tension between generalised external support for European integration and thus for enlargement on the one hand, and fears of 'trade diversion' and other damaging effects on the other.
Once we have looked at the patterns of possible 'winners' and 'losers' and at patterns of motivations, we need to examine the process of accession itself. The key focus here is two-fold: first, the ways in which the process can be seen as an economic bargaining process, and the second question, which is about the ways in which the countries of central and eastern Europe have become more 'integrated' with the EU even before becoming formal Member States; have economic actors and markets responded even in advance of the negotiations themselves?

Keywords: EU, CEE, enlargement, integration, Global Political Economy, Transition Economies

JEL classification codes: P34

Introduction

On 1 May 2004, the European Union (EU) welcomed ten new members including eight from post-communist states. With the addition of Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia (in 2007 Bulgaria and Romania), the EU now comprises of 27 nations. Together these have a combined population of 480 million.

Enlargement was initiated with the main objective to transfer into the Central and Eastern Europe the three axes of peace, stability and prosperity that the Union has already managed to achieve within the framework of Europe of the 15. This is an attempt without precedent given that no previous enlargement (1973, 1981, 1986, 1995) had neither the extent nor the expectations of the latest one.

Started in Luxemburg in 1997, the enlargement process aims at the stability and the prosperity for the entire European continent. In March 1998 the EU entered into negotiations with five Central and Eastern European Countries; the Helsinki Summit in December 1999 opened the door to another five Eastern applicants.

Since the beginning of the 1990’s, much progress has been made in the transition of the post-communist economies into capitalist market economies. Currently most of the accession countries seem to be on the right track on their reforms.

European integration has gained considerable momentum over the past couple of years. After completion of the internal market and the introduction of Euro, the European Union put Eastern Enlargement on high priority. These processes of deepening and widening integration put substantial adjustment pressure on the economies involved.

In the economic field the accession of 12 countries brought about 120 millions additional consumers into the European Union. However, some of those countries are so small that the EU economy would hardly notice their entry. Although, the impact of the accession countries in the European Union creates great opportunities and strengthens significant it’s global position.

Of course the contemporary financial crisis delivers different signs and different orientations. There is a need for a new economic plan that could recover the economies from the harmful effects of the crisis.

Previous enlargements - The economic “weight” of the EC/EU

In the period between 1950’s and 1990’s the EC/ EU has grown significantly. It has extended both its membership and the scope of its character in several important ways. The EC started as a trade bloc and it’s easily understandable from the treaties and the power that the Community gave to the Commission to represent EC in several negotiations as GATT (Tsoukalis 2003). After that, the decade of 1980’s characterized of the reform to single market union without borders and during the 1990’s from the successful effort for monetary union and the process for the biggest enlargement of the European history.

The European Community (EC) and its successor the European Union (EU) have ensured peace and stability among its member states for over fifty years. Its expansion has been publicized in the media under the term "EU enlargement", and politicians and citizens are debating its possible impact in long term period.

In 1973 Denmark, Ireland and the United Kingdom joined the six founding states (Belgium, Luxemburg, the Netherlands, Italy, France and the Federal Republic of Germany) in an enlarged European Economic Community (EEC). In 1981 Greece acceded to the European Community (EC), followed by Spain and Portugal in 1986, Austria, Finland and Sweden in 1995.

The enlargement, however, is a much broader process and with multiple aspects, which the average European can hardly grasp: The EU is being altered, transformed, and expanded; in other words, it is being enlarged. This is a fact that regards all of us and should be in the centre of our concerns with regard to the future of Europe.

The EU enlargements definitely enhance the EU's political and economic role in the global community. The reality is that the Enlargement of the European Union is an attempt with historical significance closely linked not only to the Foreign Policy of the Union but also to its internal operation. Now the Union forms the world largest trading entity (Bretherton & Vogler 1999).

According to Bretherton and Vogler (1999) the main reason of the establishment of the European Union was the stimulation of trade and economic growth. *In 1958 the trade between EC members was 35% of their overall total, by 1975 it was 49% and by 1992, 59%* (Bretherton & Vogler 1999: 47). The fact that between 1958 and 1992 the European Community enlarged from six to twelve members gave to the EC the opportunity to grown its presence in the global economy.

The European Union now is the world's leading exporter of goods: over 973 billion euro in 2001, almost a fifth of the world total (http://www.ecdel.org.au/eu_global_player/):

- The world's leading exporter of services: 291 billion in euro 2000, 23.9 % of the world total;
- The world's leading source of foreign direct investment (362 billion euro in 2000) and the second largest home for foreign investment (176.2 billion euro in 2000) after the United States (304.9 billion euro)
- The main export market for some 130 countries around the globe
- A relatively open economy: international trade accounted for over 14 % of its gross domestic product in 2000, compared with 12 % for the United States and 11 % for Japan

According to Gros and Steinherr (2004) the initial enlargement process of the EC was driven by political and economical parameters up to 1990. During this period, there was an urge for the western European countries to thrive and prosper according to what was thought to be "the western civilisation" race against the communist threat. On the other hand, eastern European countries were racing to prove there own cause. Subsequently, the collapse of the communist regimes in 1989/90 presented the countries of both eastern and western Europe with the challenge of completely redefining their relationship.

During the 1990's the eastern enlargement of the EU became a highly prioritised policy issue and not just simply an economic cost-benefit consideration. It was mostly a priority with global economic and political dimensions. The two major strategic aims of the enlargement were projecting political stability and strengthening Europe as an economic power. (Kristensen & Jensen 2001:47).

According to Dent (1997:115) in the 1990's the major motivation for the CEE countries was a closer co-operation with Western Europe. This co-operation was called the process of "Europeanization", a multiple action which included the *return to the participation in "West European cultural, political, and economic exchange"*. (Dent 1997:118)

The end of the cold war created a radical reorientation of the European Union (EU) policy towards the countries outside the Union, especially the neighbours in the eastern part of the European continent. *The immediate response was technical and financial assistance for reforms* (Sedelmeier & Wallace, 2000:428).

Western–European countries had to deal with problems such as the development of the emerging countries, China's new economic policy and Latin America's inflation problems (Gros & Steinherr, 2004). All these created the feeling of an unstable global political and economical environment. The latest financial crisis was

The economic situation in the Central and Eastern Europe Countries

The peaceful revolution which swept Eastern Europe in 1989 is probably the most significant event in global terms of the past 45 years. It is happening on the very doorstep of the European Community. It is represents a challenge and an opportunity to which the EC has given an immediate response (Commission 1990:5).

After the collapse of Communism in CEE countries, there were serious economic and political problems which these countries were urgently trying to tackle (Inflation rates, institutional reform, free market economy etc.). Joining the EU looked very promising for solving these problems.

During the 1990's the European Union was one of the major global powers with stable political environment and promising economic growth. At the same time the Central and Eastern European countries were facing problems in many sectors of the economic and political life.

For the majority of the central and eastern European state the concept of a "return to Europe", including membership of European and economic and political institutions and the redirection of their trade flows away from the former Soviet Union towards western Europe became a major political, as well as economic, objective (Smith 2000). The debate that started immediately was about the processes of political and economic transformation in CEE countries the ongoing process of EU enlargement and the question about the boundaries of Europe (Hudson 2003).

In 1990's the financial balance and the economical gap between the countries of the Eastern - Central Europe and the EU were significant, portrait in the huge gap and the difference in inflation rates

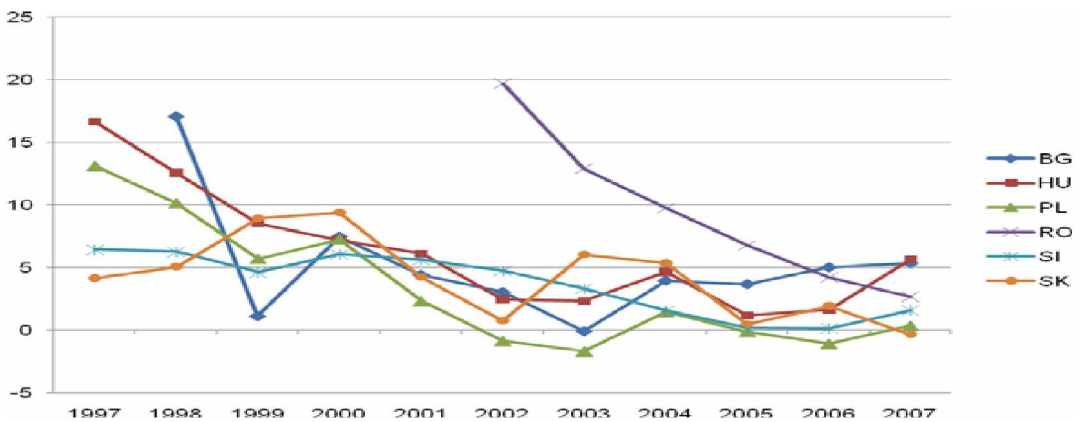

Figure 1: Inflation (High group)
Source: The William Davidson Institute, working paper number 937/2008

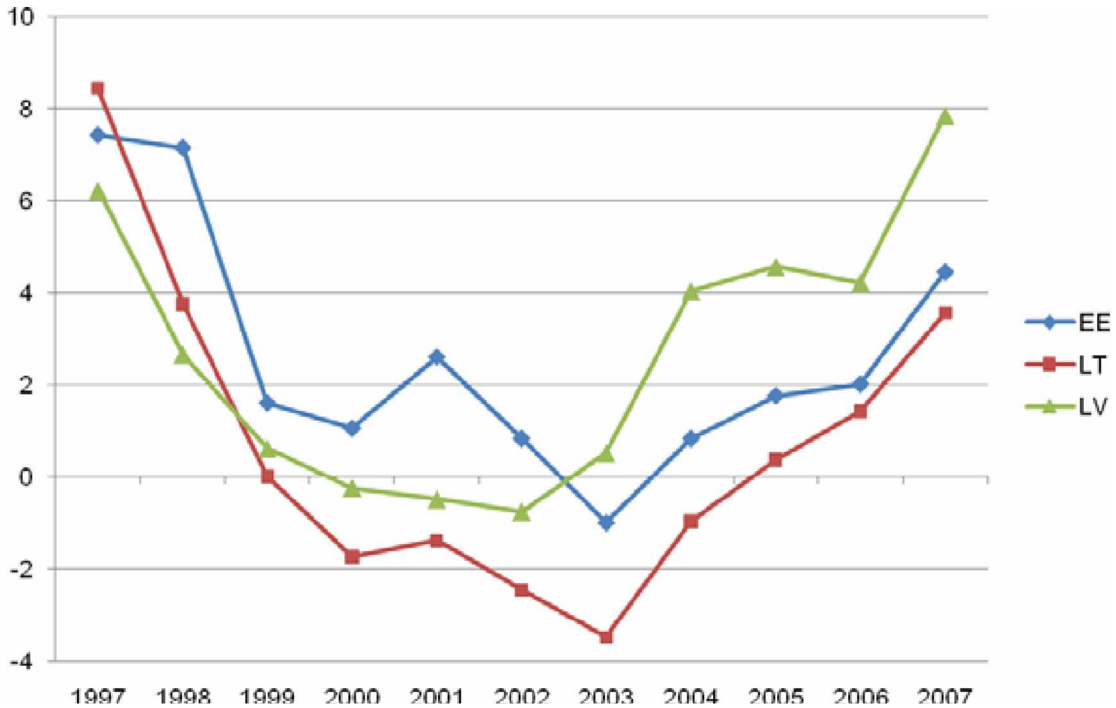

Figure 2: Inflation (Baltic group)
Source: The William Davidson Institute, working paper number 937/2008

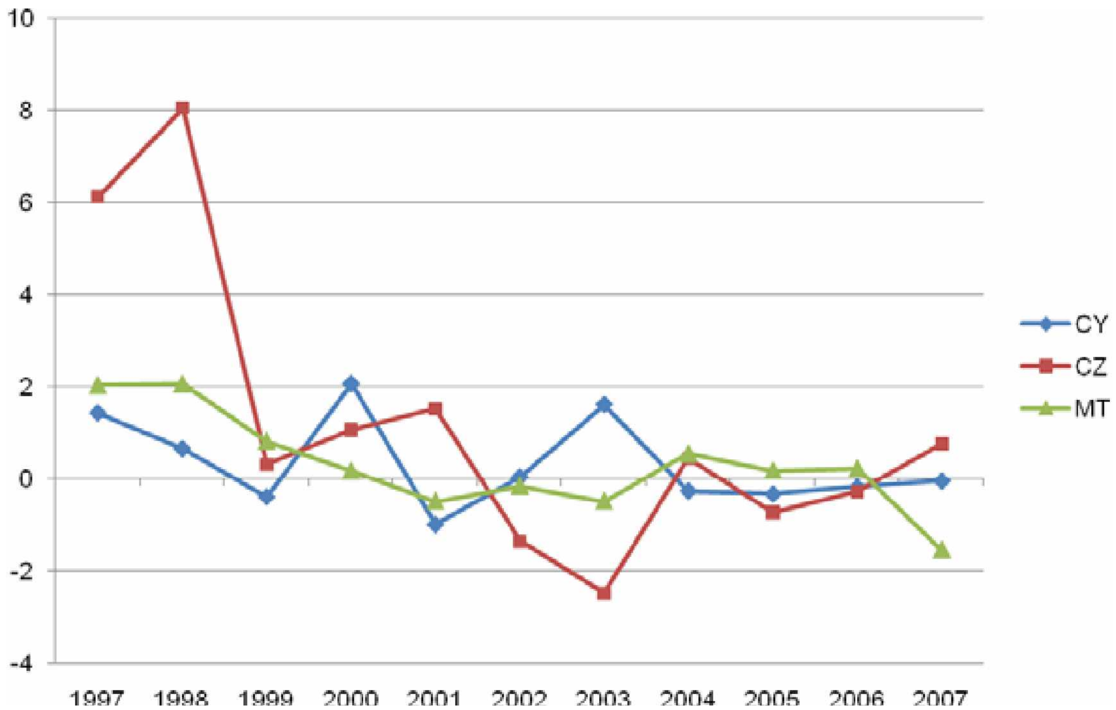

Figure 3: Inflation (Low group)
Source: The William Davidson Institute, working paper number 937/2008

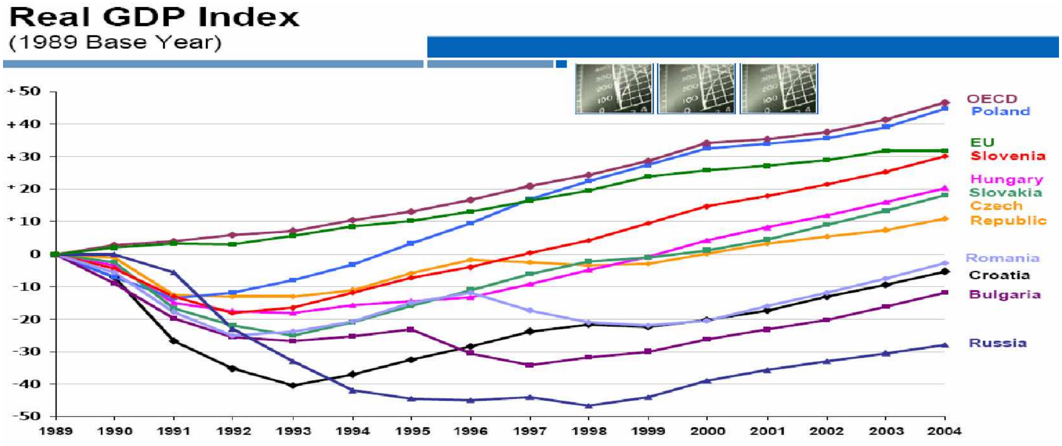

Figure 4 Gross Domestic Product in EU and the CEEC's
Source: William Davidson Institute based on EBRD Transition Report 2002

The scepticism and the economic calculus of the integration
EU wanted to embrace the CEEC's. There was a political incentive to enlarge but there was some scepticism regarding the economic calculus of admitting a large number of generally poor and economically fragile new members were particularly complex. The debate about Eastern enlargement of the EU had been accompanied by widely diverging estimates of the actual cost involved. Skeptics preferred to cite maximum figures, while proponents adopt maximum estimates. (Salvatore 2000)

There were fears in both the "old" member states and the applicant countries about the consequences of the enlargement. On one hand, the candidate countries were concerned about the social and economic consequences from the radical change of the political regime which created an uncertainty about the future. On the other hand, the "old" member states e feared the negative impacts of enlargement (Kristensen & Jensen, 2001). At the same time some argued that there were benefits to gain than to lose (Steinherr 1997) For example, the ten CEEC's have a total land area of 1.1 million square kilometers and a population of 106 million. This corresponds to 33% of the territory of the EU and 19% of its population. On average, more than 25% of the working population (i.e. a total of 9.5 million people) is employed in agriculture (EU: 6% or 8.2% million). (DFPR Working Paper 2 1996)

The issue of the enlargement of the EU is not simply an economic cost- benefit issue. The enlargement has been described by Gros and Steinherr (2004: 264) *as a political imperative*. It is first of all a project with a world political dimension, with two major strategic aims; the projecting political stability and strengthening Europe as an economic power. (Kristensen & Jensen, 2001)

From the beginning, the European Union showed the target and set the goal for the enlargement and the criteria for the accession of the candidate countries. The Treaty of the European Union (TEC) and the commitment from the European Commission that any European State could apply for membership in the EU, open a wide door for CEEC's (Bretherton & Vogler: 1999). The challenge was great and the countries that facing harmful post - communist problems had to take this chance.

Apart from the role to the accession process of the Copenhagen Council and the Essen European Council, other Councils like the

Madrid (December 1995) and the negotiations before the Treaty of Amsterdam (1997) had to deal with this very important issue for the future of the European Union. (Sedelmeier & Wallace; 2000) The Luxemburg summit of December 1997 marks the start of formal negotiations for accession. In the summit of December 2002, again in Copenhagen, the European Council decided to endorse the negotiation results achieved for as many as 10 countries. In an informal European Council meeting in Athens in April 16, 2003 the heads of the state signed an accession treaty (Kohler, 2003).

The bargain for the accession had many agreements and many more efforts for the transition and eventually the integration of the CEEC's. According to Gross and Steinherr (2004: 264) the single most important trade initiative for the transition economies were the so-called "Europe Agreements" (EA) between the EU and the Former Czechoslovakia, Hungary and Poland signed in December 1991 (Bulgaria and Romania followed a year later and the three Baltic countries and Slovenia also singed later). The main aim of these agreements was to liberalize trade between the EU and the country in question. Apart from regulating trade policy issues, they also set out the guidelines for political dialogue and for cooperation for example, in the areas of industry, environmental protection and transport. The Europe Agreements also include provisions and simplifications for bringing national laws into line with EU law, which help the accession candidates greatly in their preparations for joining the EU.

This bargain process can be viewed as "asymmetric". The EA's established a free trade area for trade in goods between EU and the respective partners within the period up to ten years. The provisions of the Agreements were "asymmetric"; the period for phasing out import restrictions was usually much shorter for the EU than for the CEEC partner. In most products the EAs allowed free entry into the EU from the start. But for other "sensitive products" (coal, iron, steel etc.) was stipulated in separate protocols for the elimination of tariffs by the EU. The agriculture remained excluded from free trade since 2000. (Gross & Steinherr, 2004: 266) Additional this "asymmetry " in trade balance can be viewed in many Mediterranean countries, according to Tsoukalis (2003:80): *"On average 50% of their trade is conducted with the EU…for several Mediterranean countries, tourist revenues and migrant remittances from EU also represents a very substantial part of their foreign exchange receipts… the relationship between the two sides is highly asymmetric."*

Before the accession there was a long period of reforms during which these countries were gradually integrated in the EU economically. The effort for the transformation reform in CEE's had a strong fight against the microeconomic and macroeconomic problems (Dent, 1997).

From that point, we could easily say that the first years of the 1990's were years of reform in the two main sectors of the economical life; Microeconomic and Macroeconomic. According to Dent (1997: 111) the "***Microeconomic** dislocation"* had the above:

- The absence of market mechanism- low productivity- no information on prices and cost.
- Differences in sectoral development- more developed the heavy industry and less developed the industry for consumer goods and services.
- The lack of a legal commercial and company structure.

- The problem of market motivation - Non- existence of property rights and absence of competitive forces.
- Repressed inflationary pressures: arising from the extensive application of price and wage controls
- Monetary policy: soft budgetary controls and the reliance of foreign debt in some countries created poor financial disciplinary conditions.
- Mass hidden unemployment

Also, according to Dent (1997: 112) there were four points of the "***Macroeconomic** imbalance*":

- Inflationary *pressures*
- Soft budgetary control and monetary policy.
- Lack of investments and the transfer from the heavy industry to consumer industry.
- High rate of unemployment

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 some are likely to see, at least temporarily, a widening of the income gap with their richer neighbors in the EU. (EU economy 2009)

Achievements of the first years after Integration in the EU

- **The accession process has contributed to significantly improve living standards in the new Member States, fostering economic and social cohesion within the Union.** Income per capita rose from 40% of the old Member States' average in 1999 to 52% in 2008.

- **Rapid trade integration has fostered a more efficient division of labor and strengthened competitiveness in the EU.** The degree of trade openness in the new Member States has reached a very high level. Their average GDP share of exports and imports now amounts to 56% of GDP, up from 47% before enlargement.

- **New Member States have been rapidly modernizing their economies.** They have developed functioning market economies and the capacity to cope with competitive pressures and market forces within the Single Market. They have also increasingly aligned their production structures with those of the old Members. Agriculture and manufacturing are more important in the new Members (amounting to 4½% and 21¼% of GDP respectively in 2006, compared with 1½% and 16¾% in the old Member States). Nonetheless, the service-based and knowledge-intensive economy has progressed in recent years. The share of services in GDP grew from 56% of GDP in 1995 to 63% in 2006, compared to 72% of GDP in the old Member States.

- **Investments from old Member States have been a key driver of economic transformation in the new Member States.** In the run-up to accession, new Member States made great progress towards macroeconomic stability and rapidly embraced the legal and institutional frameworks of the EU.

- **Investment and activities funded under cohesion policy were also instrumental to facilitating the restructuring process in the new Member States, while strengthening economic and social cohesion throughout the Union.**

- **The EU accession process also brought about a new framework for product market regulation in the new Member States, including for competition policies and state aid.** New Member States have a higher share of openly announced public procurement (5¾% of GDP against 3¼% of GDP for the EU as a whole in 2007). According to a Eurobarometer survey of 2007, 71% of small and medium-sized enterprises (compared with 63% in the old Member States) feel that there is a significant increase in competition.

- **Integration of new Member States agricultural markets and rural economies to the EU was accomplished without any major internal economic or social problems**

- **In old Member States, concerns raised about massive labor migration prior to enlargement have not materialized.**

(European Economy 1/2009)

Conclusion

The accession of eight Central and Eastern European countries (CEECs) to the European Union in 2004 brought some important benefits. The new members gain from the reduction barriers to trade and investment. By 2010, the movement of labor will also be freed. But accession to the EU is neither a necessary nor a sufficient condition for economic growth. The combined effects of market access and economic liberalization, not EU membership, optimize economic growth.
Even a full absorption of EU structural and cohesion funds will not – of itself - guarantee a lasting impact on the growth of the recipient countries or regions. It is therefore necessary to identify the conditions under which the impact of the funds can go beyond the short-term positive demand effects and generate a positive supply response in the long run.

In my opinion, we all acknowledge, apart from the economic and monetary union, the need for political union. Furthermore, by means of efficient reforms, we have to take care so that the enlarged Union continues to be in a position to reach decisions.

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