

ENLARGEMENT OF THE UNION - ECONOMIC AND FINANCIAL IMPLICATIONS INCLUDING EMPLOYMENT

A Presidency Introductory Paper by Ms. Kirsi PIHA
Member of the Grand Committee
Parliament of Finland

Enlargement of the European Union has significant economic and financial implications. From the point of view of the EU Member States, it is misleading to view enlargement only as a budgetary burden, though these burdens and other difficulties relating to enlargement should not be neglected. There may be significant economic benefits involved in the medium to long term. Similarly, the applicant countries should not be seen only as big net receivers of financial assistance from the Union. There are extensive economic costs involved in adapting to the obligations and pressures of EU membership. Above all this applies to ensuring effective application of the *acquis communautaire* by the administrative and judicial authorities of the Central and East European Countries (CEECs) and to industries coming in line with the EU environmental and social standards.

The European Council in Berlin in March 1999 laid down the financial perspective for the European Union for the years 2000 - 2006. This perspective was later approved by the European Parliament. According to the perspective, enlargement-related expenditure, including the pre-accession phase, will be just under 80 billion euro during the next financial period, based on 1999 prices. This will constitute less than 10 % of total EU expenditure during that period. This is roughly the direct budgetary consequence of the accession of a number of Central and Eastern European Countries to the Union, not taking into account the (presumably quite small) contribution to the EU own resources that the new Member States will make. Furthermore, this amount may be viewed as the maximum budgetary cost of enlargement until 2006 which will take place if all the assumptions concerning the timing and extent of accession are correct. These budgetary assumptions reflect an optimistic view of the cost of enlargement, and they are not shared by all commentators. For example, Mr. Verheugen, the new Enlargement Commissioner, has recently estimated that the costs of enlargement will be considerably higher than estimated by the European Council.

The above-mentioned budgetary costs of enlargement reflect a very narrow perspective on the economic effects of enlargement. There will be a host of other economic effects at play. Although they are of a different nature, a common factor is that they contribute towards greater economic efficiency and increased welfare.

The Rapporteur would like to thank the Finnish Ministry of Finance for rendering invaluable assistance in preparing this paper. However, the views expressed here are not necessarily shared by the Finnish Government.

One significant economic effect is an improved allocation of resources. Resources will be directed to where production is most efficient, taking into consideration all the relevant factors. The applicant countries can be seen to benefit from their comparative advantage which differs in some important ways from that of many EU Member States. A redistribution of production from some regions to others may take place. There will be losers and gainers - the former being less competitive and innovative than the latter. Notwithstanding the adjustment costs in the form of closures of businesses and unemployment, on the whole the economic effects will be improved efficiency. This translates into increased benefits for the consumers.

The enlargement of the Single Market will constitute a huge increase in possibilities for EU firms. As the standard of living of consumers in the CEECs increases, many EU firms will find expanding markets for their products. To some degree, this has already happened as consumers in the CEECs have been anxious to rapidly bring themselves in line with the standard of living in the EU countries. This effect may well become more pronounced once the CEECs join the Union.

In the future, firms in the EU countries will also find the CEECs more attractive for investments. The CEECs already have a number of assets making them attractive to investment. They are geographically and culturally close to the rest of Europe. The population is relatively well educated and labour costs are comparatively low. What is more important, the accession to the EU will significantly increase their position in attracting EU investment flows. This is due to the expanding Single Market, including the free movement of capital, and to the fact that foreign and domestic investors will be treated equally. Following the above-mentioned argumentation, it would not be surprising if investment flows from the EU countries to the CEECs increased markedly once they accede to the Union.

Consumers in the EU countries will benefit from increased competition in the market caused by the entry of products of competitive quality and prices produced in the CEECs. There will be increased variety and more fierce price competition. Again, to some degree, this effect has already happened as a result of enterprises in the the CEECs gaining from EU capital, management, research and development, production techniques and marketing their products in the EU.

On the other hand, enlargement also entails significant challenges to the proper functioning of the internal market. The administrative standards achieved by the authorities of the CEECs, for example, in the fields of VAT and excises, and customs and border control, have direct impact on our possibilities to maintain undistorted competition in the enlarged internal market. The effective application of the *acquis communautaire* by the CEECs concerns, not only harmonizing the conditions of competition between old and new member states, but also ensuring that the flow of goods and services within and between the present Member States is not distorted by competitive advantages gained by a failing or ineffective implementation or application of the *acquis* in the CEECs.

Turning to economic effects in the CEECs, they can be seen as much more dramatic than those in the EU countries. Due to some fifty years of isolation from the social development in the West, these countries are faced with the society-wide challenge of transforming the economy into one corresponding more to the market economies of the EU countries. As a starting point, we can look into the challenges faced by firms. Many of them have already been faced with decreased direct subsidies from the state, hard budget constraints, the need to increase productivity, redundancies, the threat of bankruptcy in the event of non-payment and the demands set by competition laws. Depending to a significant extent on the form of privatisation taken and the resulting ownership structure, these firms have or have not been able to face up to the challenge of the competitive environment of a market economy. As a general rule, companies run by former managers and employees (those firms privatised by so-called management-employee buy-outs) have fared the worst, while firms run by foreign strategic investors have succeeded. Employees in the CEECs traditionally counted on the workplace as, not only a source of employment and pay, but also social security. This function is no longer assumed by firms, because social security benefits and services are being developed by the governments along the lines of more mature market economies. The result of this development has been a deteriorated job security for the workers, and especially, lowering of the position of women in terms of employment, economic equality and social protection. Workers have to pay more attention to having a good education and developing their vocational or professional skills while at work. Workers also have to face increased pressures over performance and efficiency at work.

One economic effect of enlargement of the Union for the CEECs, which has perhaps not been discussed much, is the economic cost of preparing for Union membership. The latter is an extremely wide-ranging and complicated exercise, in which the CEECs attempt to catch up with EU members in all EU policies. In practice, much of this work focuses on approximation of legislation, i.e. reforming national legislation to be compatible with the *acquis communautaire*. In many of the CEECs this is an arduous process due to scarce resources and challenges in the administrations. This effect is difficult to quantify, but certainly cannot be ignored. In preparing for accession the CEECs are under great adjustment pressures with significant economic costs.

The employment effects of enlargement is an area of widely divergent views. Some foresee a mass migration of workers from the CEECs, others offer a more cautious view. At present, in spite of free movement of labour, these movements are very small in the EU. This has often been explained by linguistic and cultural differences between the Member States which hinder such flows.

It would be difficult to only support the view of the alarmists in predicting massive emigration from the CEECs as a result of accession. The cultural and linguistic differences mentioned above also apply to the CEECs. Admittedly income levels in these countries are low compared to EU Member States, but they are converging, albeit at a slow pace.

On the other hand, it cannot be denied that public opinion in the present Member States is extremely sensitive to this question. In addition to ensuring that adequate information challenging most unfounded alarmist predictions is available, it is also necessary to take seriously the concerns of the citizens relating to free movement of persons from the CEECs. Here there is a direct link between how successfully the Union puts into practice the area of Freedom, Security and Justice and the legitimacy of enlargement in the eyes of the Union citizens.

From an economic point of view, free movement of labour would result in an efficient allocation of resources as workers would seek the best available employment opportunities, be it in the EU countries or in the CEECs. Functioning labour markets would result in economic efficiency and welfare improvements. Needless to say, in reality

the picture is more complicated. There are market failures and negative externalities. However, the principle of free movement of labour should not be jettisoned as enlargement of the Union becomes a reality.

The economic consequences of enlargement of the EU have been described as a win-win situation. This conclusion can be supported, though without forgetting the necessary realism. The positive efficiency and welfare effects are likely to be substantial, both in the EU Member States and in the CEECs. Certainly these gains, along with other effects like increased stability and security, will outweigh the budgetary costs of enlargement to the EU Member States and the economic costs borne by the CEECs due to accession. The economic gains are perhaps more indirect and long-term than the direct budgetary costs, which may well be the heaviest during the next decade. The more indirect economic benefits of enlargement should be kept in mind when discussing the cost of incorporating the CEECs into the Union. However, a scenario of a lose-lose situation cannot be completely excluded either. It could emerge if the Union, for political reasons, gives up the requirement of full achievement of the economic, legislative and administrative criteria of accession by certain applicant countries. Under such circumstances the new member state(s) concerned would have to face the macro- and microeconomic costs of adapting it to the increased competition of the internal market while still being under the financial and social burdens of the economic transition. With a bit of bad luck, such a situation may entail a difficult economic and budgetary crisis both for the Union and the country concerned.

1 The Rapporteur would like to thank the Prime Minister's office for rendering invaluable assistance in preparing this paper. However, the views expressed here are not necessarily shared by the Finnish Government

01.09.1999