

Prospects for Joining the European Union

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I Introduction

For a long time, accession to the European Union (and its predecessors) by Central and Eastern European countries (CEECs) did not represent a realistic element of any major strategic approach in Europe. Even the Association Agreements² (AAs), signed just five years ago with the first three Central European transforming countries, avoided establishing any clear linkage between the AAs and potential future membership. Although the preface to the AAs contained a unilateral statement by Czechoslovakia, Hungary and Poland that these countries considered the AAs as an important stepping stone towards the historical goal of achieving full membership in the EU, this approach was not shared and supported by Brussels.

Five years later, however, the main question is no longer *whether* the CEECs (or at least some of them) will become members of the EU but *when* and . The real issues seem to be “technical”. Nevertheless, they are of the utmost strategic importance for the future of Europe and for all present and would-be member countries of European integration.

Four fundamental technical questions can be raised:

- (a) when will the enlargement (or enlargements) take place;
- (b) how and under what conditions will the accession process proceed;
- (c) why is enlargement vital not only for the newcomers but also for the present member countries of the EU and for the EU itself;
- (d) what kind of a European Union will accept the candidate countries as new full members?

The answer to these questions will be conditioned by developments occurring in four different spheres. First, developments in the global sphere have influenced and will continue to influence the enlargement process. Second, and probably more importantly in the short term, developments in the intra-European sphere – mainly Russia and some other successor states

1 The views expressed in the paper are personal and should not be interpreted as those of the Institute for World Economics or the Hungarian Task Force on Integration Strategy.

Revised version of the paper prepared for the conference on “Regionalism and Economic Integration and Global Economic Cooperation”, Prague, 13-14 January, 1997.

2 The Association Agreements were replaced by the so-called Europe Agreements at the meeting of the European Council in Copenhagen (1993). At the same time, the EU then endorsed the idea that the ten CEECs would join the EU if certain conditions were met.

of the Soviet Union – are expected to affect the modalities of enlargement. Third, processes in the intra-EU sphere seem to play a crucial role. While the EU is unlikely to block enlargement or even radically postpone its date, it can fundamentally influence conditions, costs and benefits of the enlargement and the whole integration framework in which new members are allowed to join the EU. Fourth, developments in the transforming candidate countries themselves may substantially affect the modalities of accession.³ In fact, the last two spheres have dominated both thinking and policymaking in the first half of the nineties. However, it is not yet clear how the relative weight of these four spheres might change. The growing importance of global and Pan-European issues may substantially affect the framework in which eastern enlargement will take place.

A realistic and comprehensive analysis is even more complicated because the four “technical” questions raised are interrelated and interacting. The timing of enlargement exerts an impact on the conditions of accession and vice versa. Costs and benefits are, to a substantial extent, dependent on sequencing, conditions, and the internal situation of the EU.

In addition, the issue of whether enlargement should or should not take place has been decided mainly on the basis of security and political, i.e. non-economic considerations.⁴ It is obvious that the remaining “technical” (but, in reality, very strategic) decisions on timing and conditions of enlargement will largely be based on similar considerations, even if the “policy mix” of enlargement may be changing according to global, European and intra-EU requirements.

In a nutshell, a comprehensive and all-embracing survey should address all moving objects, all moving targets and all moving external frameworks. Depending on different constellations, dozens of scenarios should be described and analysed. This, however, would go much beyond the modest task of this paper and would greatly exceed the knowledge and capacity of the author. Therefore, while concentrating on the future development of the enlargement process, some assumptions have to be set. We assume that conditions in both the global and the European spheres will not inhibit the

3 Until now, little attention has been devoted to the short and medium-term prospects of the individual CEECs. In fact, in the first half of the nineties, we witnessed a surprisingly smooth pattern of transformation, both in political and economic terms, despite the heavy economic and social costs already involved. However, most countries will only now be entering the more difficult period of transformation, in which they have to find answers to basic questions swept under the carpet in the first years. One can only hope that also these tasks will be solved as efficiently and smoothly as previous challenges had been faced.

4 Evidently, dynamic economic interaction between the EU and the CEECs represented by high growth rates of bilateral trade flows, growing intra-industry trade and booming foreign direct investments in some CEECs have successfully contributed to shaping the (micro)economic framework of the positive decision on enlargement.

enlargement process in the next, crucial period of about 5 to 10 years.⁵ We also assume that the next stage of the transformation process will not produce major socio-political and economic instabilities, at least not in the more promising candidate countries. Finally, we assume that the internal reforms of the EU will proceed according to Brussels' (and most member countries') plans, certainly not without difficulties and delays, but hopefully without paralysing or even breaking up the integration process.⁶ Thus, it is assumed that the EU will be able to maintain its main priorities, including enlargement, despite the fact that it will have to give more attention to some obvious, pressing issues such as unemployment, internal security and internal cohesion.

There is another serious limitation to our approach which stems from the fundamentally policy-taker status of the CEECs and the largely policy-maker status of the EU.⁷ Any accession strategy developed by the CEECs has to consider the fact that most decisions on enlargement (timing, conditions, forms, modalities, etc.) will not be taken by the candidate countries but by Brussels and the present member countries that are in a much stronger position than the CEECs. Therefore, a more comprehensive survey should include the various EU options before analysing realistic accession strategies.

This paper, however, focuses on the CEECs' preparation for membership, with special regard to the Central European countries (CEFTA-4 or CEFTA-5). It is structured in the following way. Part Two describes the basic framework conditions of preparing for membership. Part Three provides a short presentation of the current level of preparation. Part Four deals with some domestic tasks whose solution may be vital for efficient and successful preparation in the coming years. Selected priority topics of negotiation on accession will be addressed in Part Five. Part Six collects arguments for *why* to enlarge and deals mainly with benefits from enlargement for the EU. Part Seven surveys the modalities of *how* to enlarge. The paper ends with some concluding remarks.

5 Considering that the eastern enlargement of the EU will be gradual.

6 Included in this "package" are the gradual reform of the common agricultural policy, some basic achievements in the institutional field (although more might be necessary at a later stage), the implementation of EMU with strong political support but, unfortunately, not without strong economic repercussions a few years later, agreement on the future of structural funds and the reduction of the "democracy deficit" in the member countries' societies.

7 It does not invalidate serious attempts of the CEECs to pursue a more active policy of shaping the future of European integration. Certainly, the policy-taker status must not be considered as a one-way (passive) adjustment. However, the basic sense of Realpolitik has to be maintained (also in order to use important "niches of active influence").

II Framework Conditions of Preparing for Membership

Three Levels of Preparation

At present, preparation for membership can be observed on three different levels.

- (a) The first level involves the requirements stipulated by the AAs. In the last months, some developments in the EU-CEECs relations and intra-EU issues seemed to put this highly important issue into the background. However, it has to be clear to each applicant country that future membership crucially depends on the fulfilment of the AA. It is the AA which contains the framework of trade liberalisation and the creation of a free trade for non-agricultural products by 2001, no matter whether the associated country will or will not join the EU immediately after this date. In addition, the AA enshrines a large part of the adjustment tasks, generally known as the *acquis communautaire*. It is evident that without meeting the requirements involved in the AAs, no membership can materialise. As far as trade provisions are concerned, the AAs have reached their mid-point. In the next years, the temporary trade asymmetry granted by the EU has to be reversed, so that the associated countries will have to dismantle their existing tariff- and non-tariff-barriers.⁸ It has to be stressed that other areas covered by the AA have, in the best case, a three-year track record only. As a result, a large number of non-trade-related liberalisation measures will be due in the next five-year period (including the creation of the necessary legal framework). The tasks have to be performed in a qualitatively new (to some extent improved, to some extent critical) period of transformation *and* modernisation, accompanied by serious trade, and potential financial and other imbalances (see later).

If they fully respect the AAs, the associated countries will become members of a large European free trade zone. Some of them are likely to be seriously hit by a new trade asymmetry, now in favour of the EU. Since trade in agriculture will not be fully liberalised, those associated countries with a high share of agricultural exports to the EU and a low share of agricultural imports from the EU may suffer the negative impacts of asymmetrical trade liberalisation. Among other arguments, this factor points to the need for a smooth and quick transition from the AAs to full membership.

⁸ By the end of 1996, the EU has abolished all restrictions except for trade in agricultural commodities, which will not be totally liberalised until 2001.

- (b) The formidable tasks ahead have been temporarily eclipsed by the answering of the EU questionnaires in 1996. All candidate countries have filled out this document and initiated a follow-up period with new questions, answers and clarifications. This period is expected to last until shortly before the Amsterdam summit of June 1997 and will end with a report (*avis*) to be presented by Brussels in order to determine the countries which will begin accession negotiations in the foreseeable future.

Although the EU sent out the same questions (in the same structure), and, for obvious political reasons, wanted to avoid any kind of premature differentiation, the incoming answers can provide motives for preselection. On the one hand, the understanding of some questions and the importance attached to them is a good indicator of the level of EU maturity of a given country. On the other hand, the “internal cohesion and logic” of the answers sheds light on the general political, economic, legal, social, etc. situation of the candidate. Third, by comparing and contrasting the answers with information received from other sources (including EU firms located in the applicant countries) and with the political and socio-economic reality, additional useful inputs can be gained. It is, of course, a different question whether the EU wants to use the varying quality of answers as a tool of preselection, and if so, at what time.

Beyond providing important information to the EU, the answering of the questionnaire has contributed to the domestic process of preparation as well. It has truly reflected the professional ability of civil servants in each country. Moreover, it has forced different ministries, with often very different particular interests, to cooperate with each other, for many questions could not have been correctly answered without the input of various government divisions. Also, new priority areas of preparation became clear, including the improvement of public administration and better statistical services. In some countries, it was the questionnaire that made governments aware of the key importance of strategic thinking and acting during the preparatory period.

In sum, the filled-out questionnaire can be regarded as the most comprehensive (although not all-embracing) document prepared in the applicant countries after the radical political and economic transformation started.⁹ It is unlikely that such an effort would have been under-

⁹ In the case of Hungary, the last comprehensive survey, limited mainly to economic issues, was prepared before the introduction of the new economic mechanism in 1968. Poland may have undertaken a similar exercise in 1989-1990. Most other countries, however, did not prepare any comparable report for decades.

taken as a result of purely domestic initiative. In this case, “mild external pressure” proved a welcomed catalytic agent.

- (c) Lessons drawn from the questionnaire have strengthened the importance of full-fledged pre-accession strategies even in those countries which started to elaborate such an approach in recent years. The pre-accession strategy covers three periods:
- preparation for starting negotiations (elaboration of the negotiation strategy);
 - period of negotiations until membership;
 - first years of full membership with continuous and further adjustment, due to derogations and new challenges deriving from membership.¹⁰

Time Schedule Membership Preparation

This paper is based on the assumption that country reports (*avis*) will be ready by mid-1997, and virtual negotiations can start early in 1998 with all or some of those countries receiving positive *avis*.¹¹

According to the Madrid summit and reinforced by the Dublin summit, negotiations on enlargement are set to start six months after “successfully finalising” the Inter-Governmental Conference (IGC). We can only speculate what “successful” and what “finalising” in this context mean. Most probably, the IGC will produce some success (although less than many would have expected and much less than necessary for a fundamental reform of the decision-making process even in the present Union). Also, it is likely that the IGC will be finalised before end-summer of 1997, although it will certainly not be the last highest-level conference on institutional reforms. Anyhow, negotiations on accession, pushed both by Pan-European developments, intra-EU efforts and pressures coming from the candidate countries, are expected to start in early 1998.

10 Potential Central and Eastern European member countries should avoid the problems Austria, and to some extent also Sweden have been facing after membership. Integration strategy has to be maintained at least in the first years of full legal membership, because several adjustment problems will become clear immediately after becoming a full member.

11 Some experts expect that, because of political consideration, all applicant countries will get a positive *avis* from the Commission. A negative *avis* would probably mean the postponement of negotiations indefinitely, although there is a contrary case known in the practice of integration (Greece started and successfully finished negotiations with a negative *avis*). It must be emphasised, however, that the final decision will be taken by the Council of Ministers, which has the right to change the opinion of the Commission. As a result, at least in principle, it is possible that negotiations will start with a country on which the Commission presented a negative opinion and vice versa.

12 It may even become more complicated as a result of institutional and other reforms to be introduced before or during the accession negotiations.

It is more difficult to predict the duration of the negotiations. Obviously, it will depend on the level of preparation of both parties. The CEECs are interested in quick negotiations and are therefore well-advised to have a clearcut negotiation strategy based on a few carefully selected priorities. At the moment, the preparedness of the EU is less evident. It will depend on the state of various internal reforms, on global and European developments and also on the approach to be chosen for starting negotiations (startliner vs. group approach). Comparisons with the length of earlier negotiation periods are hardly useful, because the agenda to be negotiated on is different from previous agendas. Moreover, the EU now is a much more complicated institution than in earlier negotiation periods.¹² In addition, the more advanced CEECs have already liberalised their economies more than the Mediterranean member countries did before becoming members,¹³ and will continue to do their homework before starting negotiations.

As a result, negotiations, if well-prepared on both sides, may last about two years. Another unknown factor is the duration of the ratification process in the 15 member countries and the European Parliament, as well as the referendum in the potential member countries. According to a current realistic scenario, full membership for the first CEECs can be envisaged for 2002.

III Present Level of EU Maturity

In the last years, all CEECs have undertaken serious efforts to comply with the so-called Copenhagen criteria and to gradually adopt the *acquis communautaire* as laid down in the White Paper of Cannes. For various reasons, however, their performance is rather different and the gap among well-performing and less well-performing countries may even widen in the next few years. While a selection based on political criteria seems to be relatively easy, economic maturity is much more difficult to be rightly assessed. First, the candidate countries, including the more advanced ones, are in different stages of economic transformation. Therefore, even their macroeconomic indicators are hardly comparable.¹⁴ Evidently, countries which have already undergone microeconomic restructuring with deep

13 Not only their trade liberalisation is much more advanced. The level of demonopolisation and privatisation cannot be compared with that of Greece, Portugal or Spain at the date of the latter's accession to the EU.

14 This holds particularly for (statistically registered) growth, unemployment, inflation, budgetary position, trade and current account balance.

structural reforms in the implementation phase reveal different features than countries which have not yet undertaken such (unavoidable) steps. Second, as the first stage of transformation characterised by macroeconomic stabilisation enters its second stage called transformation with modernisation, microeconomic agents become more and more important. If the macroeconomic stabilisation did not give sufficient attention to firm-level restructuring (which was the case in most countries)¹⁵, the problem of “repressed microeconomic modernisation” with serious consequences for employment, budget and external balance has to be faced. Third, as adjustment to the EU digs deeper and deeper into the productive, institutional and social structure of the CEECs, the largely different micro-level adjustment capacity of the individual countries becomes increasingly manifest. A telling case in point is the difference between legal harmonisation on the level of law-making and the enforcement of new standard laws (both in legal, social and financial terms).

In sum: parallel with economic modernisation and adjustment to the EU rules, we expect a widening performance gap among the candidate countries. Also, as a result of individual efforts, the gap between the EU average and the most promising candidate countries may be temporarily widening (e.g. in per capita real income, if and when the produced GDP is used for financing future-oriented and competitive investments instead of current consumption). In order to avoid further fragmentation, both between the EU and the candidate countries and among the candidate countries themselves, the EU should become aware of its role as “modernisation anchor” for the whole transforming region.¹⁶

The seriousness of preparing for membership has been underlined in most countries by the creation of a new and more efficient institutional framework for decision-making on integration-related issues. At least the Central European countries have realised that they need a transparent national integration strategy which goes beyond legal harmonisation, trade policy or even economic policy. Evidently, all of these elements are an integral part of such a strategy, but they have to be subordinated to the strategic goals to be achieved through membership.

Several countries have created a comprehensive institutional structure of preparing for integration. At the top, an integration cabinet chaired by the Prime Minister is preparing and/or taking strategic decisions. A Secretariat of European Integration deals with high-level technical issues and coordi-

15 Here the different time requirement of (shorter-term) macroeconomic stabilisation and (longer-term) microeconomic restructuring has to be taken into account.

16 In this context, the AAs are a helpful but insufficient instrument. New, large-scale EU projects, preceding membership and facilitating adjustment, are not in sight.

nates the work of government institutions involved in integration tasks. Inter-ministerial committees and the Parliaments are part of the new institutional set-up too.¹⁷

The progress of integration can best be followed in the field of factor integration. Excluding labour, bilateral flows of commodities, services, technologies and capital witness the rapidly evolving new pattern of division of labour between the EU and (most of) the candidate countries. In

Table 1 Share of Selected Countries and Regions in Total Extra-Imports of the European Union
(percentage of total extra-imports)

Exporting countries	1989	1992	1994	1995
Poland	0.86	1.45	1.96	2.25
Czech Republic	0.57 ^a	1.13 ^a	1.42	1.65
Slovakia	^a	^a	0.43	0.57
Hungary	0.58	0.82	1.17	1.39
CEFTA - 4	2.01	3.40	4.98	5.86
Slovenia	—	—	0.73	0.78
CEFTA - 5	—	—	5.71	6.64
Turkey	1.23	1.35	1.52	1.70
Canada	2.18	1.84	1.90	2.15
Brazil	2.33	1.87	2.11	1.98
Mexico	0.61	0.60	0.52	0.59
India	0.93	1.00	1.40	1.43
Thailand	0.75	1.16	1.28	1.22
Malaysia	0.78	1.01	1.54	1.68
Singapore	0.90	1.16	1.58	1.61
Rep. of Korea	1.55	1.52	1.79	2.01
Hong Kong	1.43	1.21	1.37	1.31
Taiwan	2.06	2.20	2.11	2.16
PR of China	2.04	3.44	4.75	4.84
ACP countries	4.31	3.68	3.69	3.64
Latin America	5.80	5.02	5.53	5.58
Africa	—	—	9.17	8.83
North Africa	4.29	4.53	4.51	4.15
4 small tigers ^b	5.94	6.09	6.85	7.09
6 modernizing Asian countries ^c	7.47	8.26	9.67	9.99

^a former Czechoslovakia

^b Hong Kong, Korea, Singapore, Taiwan

^c as above plus Malaysia and Thailand

Source: Own calculations based on Eurostat 6B, External Trade. Monthly Statistics, various issues.

¹⁷ In the case of Hungary, the structure is complemented by an independent Strategic Task Force on European Integration addressing strategic questions of integration and advising the Government.

Table 2 Changes in the Relative Competitive Position of CEFTA in Extra-EU Imports
(share of CEFTA always 100)

Countries and regions	1989	1992	1994	1995	1994	1995
		CEFTA - 4			CEFTA - 5	
CEFTA	100	100	100	100	100	100
Norway	171	104	92	80	80	70
Switzerland	356	210	162	138	141	121
Turkey	61	40	31	29	27	26
Canada	109	54	38	37	33	32
Brazil	116	55	42	35	37	30
Mexico	31	18	11	10	9	9
India	46	29	28	26	24	22
Thailand	37	34	26	21	22	18
Malaysia	39	30	31	28	27	25
Singapore	45	34	32	27	28	24
Rep. of Korea	77	45	36	33	31	30
Taiwan	103	65	42	37	37	33
Hong Kong	71	36	28	23	24	20
PR of China	102	101	95	82	83	73
ACP	215	108	74	64	65	55
Latin America	291	148	111	98	97	84
North Africa ^a	214	133	91	73	79	63
4 small tigers ^b	296	180	138	120	120	107
6 modernizing Asian countries ^c	372	244	195	169	169	150

^a Algeria, Morocco, Tunisia, Libya, Egypt

^b Hong Kong, Rep. of Korea, Singapore, Taiwan

^c Hong Kong, Rep. of Korea, Singapore, Taiwan, Malaysia, Thailand

Source: Own calculations based on Eurostat 6B, External Trade, various issues.

addition, and underlining the already mentioned differentiation process, different patterns of division of labour are already emerging even among the Central European candidate countries.

As a result of dramatic shifts in the last six years, the share of the EU in total exports and imports of the CEFTA countries already accounts for 60 to over 70 per cent, which is a clear sign of EU maturity. More important is the fact that geographic reorientation has been accompanied by the gaining of market shares of CEECs in extra-regional imports of the EU. The share of CEFTA-4 in total EU extra-regional imports amounted to 2 per cent in 1989 and reached almost 6 per cent in 1995 (Table 1). CEFTA's competitive position improved dramatically vis-à-vis all major non-EU exporters to the EU. For example, in 1989 Norway alone exported almost twice as much to the EU as the CEFTA-4, but in 1995 Norway's exports

were only 80 per cent of those of CEFTA-4. Brazil, Canada and Taiwan each exported in 1989 more to the EU than CEFTA-4, while in 1995 these three countries together exported only one-third of CEFTA-4 exports to the EU. Perhaps the most telling example is the comparison between the four small Asian tigers and CEFTA. In 1989, the former's exports were almost three times higher than those of CEFTA-4. But in 1995, they exported just 20 per cent more to the EU than CEFTA-4 and only 7 per cent more than CEFTA-5 (Table 2).

It is of strategic importance that trade reorientation and growing competitiveness were accompanied by unprecedented structural changes in the export pattern of the CEECs. Although trade liberalisation carried out by the EU has contributed to the rapid increase of exports, it has remained a minor factor concerning the evolving commodity pattern of exports. It is remarkable when predicting the pattern of division of labour based on comparative advantages that the most dynamic impacts on exports emerged in non-sensitive areas, such as machinery, car parts, electronics and other non-sensitive consumer goods. In Hungary's total exports to the EU, machinery and transport equipment (SITC 7) accounted for 36 per cent in 1995 (as compared with 13 per cent in 1989). In the exports of other CEFTA countries, other manufactured goods (SITC 6+8) play a decisive role. In 1995, the structure of EU imports from the CEFTA-5 and from the whole group of non-EU countries indicate a clear CEFTA specialisation in manufactured goods (49 vs. 30 per cent) and a rapidly decreasing specialisation in machinery (27 vs. 32 per cent) (Table 3). Structural upgrading on the important German market is even more telling. A comparison between CEFTA-4 and the three Mediterranean EU member countries shows that CEFTA-4's exports to Germany reached just 50 per cent of imports from Spain, Portugal and Greece in 1989. In 1995, however, CEFTA-4 already exported almost 20 per cent more to Germany than the three EU member countries together. Regarding machinery exports, the CEFTA:Mediterranean relation changed from 40:100 in 1989 to 170:100 in 1995.

Although the engine of export growth in each CEFTA country was manufactured goods, there is a growing differentiation in the export patterns of the individual countries. This becomes particularly evident if the structure of incremental exports is calculated. Between 1992 and 1995, all CEFTA countries substantially increased their exports to the EU. 60 per cent of the increase of Polish exports and 47 per cent of exports from the Czech and Slovak Republics were due to increases in exports of manufactured goods (SITC 6+8). In turn, in Hungary's exports to the EU, machinery (SITC 7) played a dominant role with 54 per cent of total export increase (Table 4).

Table 3 Commodity Structure of Imports by the European Union from the CEFTA Countries

(total exports of each CEFTA country to the EU = 100)

		0+1	2+4	3	5	7	6+8
EU extra-imports	1994	8.4	6.8	13.3	7.3	31.7	29.7
	1995	7.9	7.4	11.9	7.9	31.8	30.3
Poland	1994	9.0	5.8	10.3	4.7	16.2	52.8
	1995	7.2	5.1	8.2	5.6	18.6	53.9
Czech Republic	1994	3.6	9.1	4.4	7.7	24.0	49.2
	1995	2.9	8.0	3.9	7.4	28.2	47.8
Slovakia	1994	2.3	5.5	2.9	8.7	17.2	60.2
	1995	1.7	5.0	1.9	9.2	25.4	55.5
Hungary	1994	13.1	6.5	3.3	7.7	28.7	39.6
	1995	10.5	5.6	2.7	7.8	36.0	36.2
Slovenia	1994	2.0	2.6	0.0	4.1	33.3	57.2
	1995	1.4	2.9	0.1	4.3	34.6	56.0
CEFTA - 5	1994	7.1	6.3	5.5	6.3	23.1	50.3
	1995	5.7	5.7	4.5	6.7	27.1	49.0
Romania	1994	3.9	3.0	2.9	5.0	8.6	75.3
	1995	3.1	2.3	1.7	5.6	9.5	76.6
Bulgaria	1994	13.7	8.9	1.6	10.4	12.1	52.6
	1995	10.0	8.7	1.0	13.0	7.8	58.6

Source: Own calculations based on Eurostat 6B, External Trade. Monthly Statistics, Nos. 8-9-10. 1996.

Table 4 Commodity Pattern of Incremental Imports by the European Union between 1992 and 1995

(incremental imports of selected regions and countries = 100)

Imports from	total	0+1	2+4	3	5	7	6+8
Extra-EU total	100.0	8.3	11.1	-0.5	16.1	47.7	32.8
Former USSR *	100.0	2.2	15.8	11.0	14.3	0.6	59.1
Poland	100.0	0.5	0.3	9.7	3.9	26.8	60.0
Czech+Slov. R. **	100.0	1.1	7.1	3.6	7.2	33.0	46.9
Hungary	100.0	2.0	4.4	3.9	5.5	54.3	29.1
CEECs ***	100.0	2.1	8.0	5.4	8.2	23.0	53.3
Visegrád Group ****	100.0	1.1	3.9	5.7	5.7	35.9	47.1

* For 1995, Russia and Ukraine only

** For 1992 former Czechoslovakia

*** For 1992 CEECs and former Soviet Union, for 1995 CEECs and Russia and Ukraine

**** Czech Republic, Hungary, Poland, Slovak Republic

Notes: EU-12 for 1992 and EU-15 for 1995.

Sums larger than 100 reflect shrinking SITC 9 shares between 1992 and 1995. Negative figures indicate decreasing import values between 1992 and 1995.

Source: Own calculations based on Eurostat, External Trade, Monthly Statistics, no. 7. 1994 and nos. 8-9-10. 1996.

The rapidly growing competitiveness of the CEECs in general and that of the CEFTA countries in particular is demonstrated in Table 5. Between 1992 and 1995, CEFTA-4 accounted for 27 per cent of the total incremental extra-regional imports of the EU (or more than ECU15 billion from the total increment of ECU57 billion) while it had a share of 39 per cent (ECU 7.1 billion) in the EU's manufactured goods imports (SITC 6+8) and slightly more than 20 per cent (ECU 5.5 billion) in its imports of machinery (SITC 7).¹⁸

It is not the aim of this paper to analyse the underlying motives of structural upgrading and differentiating export patterns. It suffices to mention that they are the result of different macro and microeconomic policies, different privatisation practices, different sizes and patterns of foreign direct investments as well as different economic, institutional and socio-cultural structures.

Table 5 Share of CEECs in the Incremental Imports of the European Union Between 1992 and 1995, by Main Commodity Groups

(total extraregional imports of EU in each commodity group = 100)

Imports from	total	0+1	2+4	3	5	7	6+8
extra-EU total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Former USSR *	11.9	3.2	17.0	**	10.6	0.1	21.4
Poland	9.1	0.5	-0.2	**	2.2	5.1	16.6
Czech+Slovak R. ***	11.5	1.5	7.4	**	5.1	8.0	16.5
Hungary	6.3	1.5	2.5	**	2.2	7.2	5.6
CEECs ****	59.7	14.9	43.4	**	30.4	28.9	96.9
Visegrád Group *****	26.9	3.5	9.7	**	9.5	20.3	38.7

* For 1995, Russia and Ukraine only

** cannot be interpreted for declining total EU extra-imports were accompanied by growing imports from CEECs

*** For 1992 former Czechoslovakia

**** For 1992 CEECs and former Soviet Union, for 1995 CEECs and Russia and Ukraine

***** Czech Republic, Hungary, Poland, Slovak Republic

Notes: EU-12 for 1992 and EU-15 for 1995. Negative figures indicate decreasing import shares between 1992 and 1995.

Source: Own calculations based on Eurostat, External Trade, Monthly Statistics, no. 7. 1994 and nos. 8-9-10. 1996.

18 In fact, almost 60 per cent of the total increase in the EU's incremental extra-regional imports and nearly 100 per cent of the SITC 6+8 group between 1991 and 1995 originated from the CEECs (including Russia and the Ukraine).

At any rate, by measuring the share of the EU in the total trade of the CEFTA countries, the pattern of exports and the level of intra-industry trade, as well as the inflow and pattern of FDI, all Central European countries seem to qualify for EU membership. Their performance and the integration level already achieved are much higher than those of some member countries not only before their accession but even today (Greece, Finland, partly Portugal and Ireland).

IV Priority Areas of Further Adjustment

Despite the surprisingly successful adjustments, as indicated by selected trade figures, even the most advanced associated countries will have to make further efforts to qualify for membership by 2002.

First, they will have to carry out the legal adjustment and adopt the substantially expanded (and perhaps to be expanded) *acquis communautaire*. As already mentioned, it does not mean exclusively making laws according to EU standards. More importantly, it requires the enforcement of EU-standard laws and the careful selection and negotiation of possible derogations.

Second, by 1997 all countries will be entering the period of “reversed asymmetry”. They will have to create a free trade for industrial products within five years. The conditions are not promising, taking into account the already high deficit in most countries’ bilateral trade with the EU. Between 1992 and 1995, the CEFTA-5 accumulated a four-year trade deficit of ECU22.7 billion,¹⁹ and 1996 has produced another record deficit for Poland, the Czech Republic and Slovakia. As a result, trade liberalisation has to be implemented under circumstances of persistently high and even increasing trade deficits.²⁰ In addition, all CEFTA countries have now entered a qualitatively new stage of transformation, in which rapid economic modernisation is a precondition of sustainable transformation and of successful integration into the EU. As in countries poor in raw materials and at a medium level of development, modernisation generally starts with high imports, the trade balance is likely to be worsened even more in the next years which are crucial for preparing for membership. Also the import requirement of “repressed microeconomic adjustment” has to be added. Obligations deriving from WTO rules and the elimination of still appli-

19 In four years, total Polish trade deficit with the EU amounted to ECU8.8 billion, for the Czech and Slovak Republics ECU6.9 billion, for Hungary ECU5.1 billion and for Slovenia ECU1.9 billion.

20 There are rather limited opportunities to finance EU-related trade deficit from other bilateral trade relations. Just the opposite is the case, as all CEFTA countries carry a permanently high trade deficit with Russia, due to the latter’s energy deliveries.

cable import surcharges have to be considered. Moreover, EU member countries, suffering under the strict Maastricht criteria and with low GDP growth, are likely to find outlets for an increasing share of their production in CEFTA countries and will thus contribute to the deterioration of CEFTA's trade balance. Even in the most optimistic case, considering the temporary character of this "gap" between exports and imports alone,²¹ the financing of the trade deficit may become and remain a key problem for about the next five years.

As the reintroduction of import restrictions (in whatever form) would be highly counterproductive for negotiations on accession and would certainly be used by some EU member countries (or interest groups) as a good argument against enlargement, mainly "non-trade policy" elements of financing the deficit have to be found. Foreign direct investments, EU-style support to enhance exports, invisible incomes, new credits (leading to higher but hopefully not dangerous levels of indebtedness), and/or the partial use of available foreign reserves may help overcome this situation. The real question is, however, whether these elements, in whatever combination, will be sufficiently high to compensate for the deficit. And what happens if this is not the case, or if the financing of deficit leads to high-level indebtedness? The situation becomes even more complicated if the possibilities and consequences of devaluation, as the most obvious instrument to improve the competitive position of exports, are considered. What happens if a major devaluation cannot be avoided (which, sooner or later, is most likely)? As a large part of foreign exchange reserves are portfolio investments seeking advantage in the higher interest rates offered at fixed exchange rates, the giving up of the fixed exchange rate policy would immediately lead to a dramatic outflow of capital desperately needed to finance import surplus.²² How could external balance, anti-inflationary policies and budgetary equilibrium, just to mention some of the key issues, be maintained under such conditions? And all this in a crucial stage of preparing for joining the EU.

Third, applicant countries are advised to achieve higher or sustain already high growth rates. Growth, however, can threaten macroeconomic stability, as already happened in some countries and, according to the scenario described above may happen in some others. One of the most difficult tasks is to coordinate stability-sustaining and growth-enhancing poli-

²¹ This expectation is based on the assumption that today's imports serve tomorrow's export capacities.

²² In contrast with Hungary, a large share of foreign capital in Poland and in the Czech Republic is portfolio and not direct capital investment. Beyond the different exchange rate policies, the different patterns of privatisation also supported this kind of capital investment.

cies. In the years of preparation for membership, in general terms, one could argue for a minimum level of stability accompanied by high growth rates. This, however, can only be achieved if a country has either substantial stability reserves, or a new, competitive structure as a result of the implementation of microeconomic transformation.

There are many arguments in favour of sustainable growth in the CEECs. Higher growth makes restructuring in general, and reforming of the social welfare system in particular easier.²³ Growth in itself is considered as a pillar of economic and socio-political stability. (Not only is stability expected to lay the foundation of sustainable growth, but growth is also creating stability.) One powerful argument in favour of higher growth is to make hesitating EU member countries interested in the accession of high-growth countries to the EU. This is particularly important for EU member countries which fear the competition of the newcomers for EU markets and funds, and also fear the competition of other EU member countries in the newcomer's markets. As a result of EMU and strong budgetary discipline, the existence or emergence of new high-growth markets is expected to attract special attention from the business community. Finally, at least in the medium term, high growth is likely to reduce EU funding of CEECs and to ease pressure on the redistribution of transfers.²⁴

Fourth, sustainable growth has to be based on exports and investments. As CEECs have to further strengthen their international competitiveness and have to recreate production capacities lost during the initial years of the transformation, there is no other way than to substantially increase domestic and foreign savings and attach priority attention to investments. Current accumulation rates of about 20 per cent of the GDP are absolutely inadequate to successfully prepare for full membership within a few years. Since even the most advanced candidate countries are historically poor in physical capital and only have a limited saving capacity, successful pre-accession strategies would need EU transfers earlier than full membership materialises, and particularly in the crucial years of preparing for accession (see below).

Fifth, investment-led growth in itself requires the fundamental redistribution of national income from consumption (both private and public) towards investment. Such reallocation of resources also calls for reforming the inherited structure of social welfare. As a result, radical and transparent

23 It is always easier if the redistribution of the GDP only raises the question of redistributing the increment and not that of redistributing already gained (hardly fought) assets.

24 On the contrary, slow growth may increase fears of larger transfers towards slow-growing countries and, as a result, enhance concerns of some member countries about enlargement.

budgetary reforms cannot be avoided. They have hardly started in some countries, while governments in other countries fear the political, economic and social protest of their citizens. One of the most difficult tasks ahead is the implementation of budgetary reforms which are needed to increase competitiveness and adjust to EU standards, and the maintenance of political and social stability which is also needed for future membership.

It should be added that budgetary reforms are also necessary to establish the institutional structure for efficient absorption of future EU transfers and to create the necessary domestic cofinancing resources well before full membership becomes reality.

V Some Expected Key Issues of Negotiating on Accession

The view is generally shared that negotiations on accession will centre on “hard core” issues. As in earlier negotiations, also the next round of enlargement will also produce derogations on both sides. However, at present it is impossible to identify the scope and areas of derogations, because they will depend on the negotiation strategy of both parties (quick negotiations with less problematic areas or longer negotiations with more issues to be raised). In addition, the future of CAP, the scope of institutional reforms and, first of all, the new pattern of structural funds and transfers are likely to affect derogations substantially. Agreements on many issues will be intersectorial, so that more flexibility of the candidate countries in one area may be compensated for by greater flexibility of the EU in other areas and vice versa.

Despite all these uncertainties, four fundamental issues have been singled out in this paper: agriculture, financial transfers, manpower and sovereignty.²⁵

Agriculture

For most CEECs agriculture is a much more important sector of economic activity, exports, employment and social cohesion than for the EU. Nevertheless, there are tremendous differences among the candidate countries, which makes any general assessment meaningless, or even more, dangerously distorted.

Fears of the EU that cheap Central and Eastern European agricultural exports may flood EU markets proved completely unfounded.

²⁵ Evidently there are additional key issues, such as environment, transportation or the institutional capacity of the applicant countries.

Transformation problems, uncertainty about land ownership, dramatic decline of agricultural production in most countries and agricultural protectionism prevailing also in the framework of the AAs have led to declining or stagnating agricultural exports to the EU. While the EU's extra-regional agricultural imports grew by 12.2 per cent between 1992 and 1995, those from CEFTA-4 increased by only 9.1 per cent. Agriculture remained the only one-digit commodity sector in which the CEFTA-4 could not increase its market share. While in Hungary's total exports the share of the EU amounts to 64 per cent, in the country's agricultural exports the EU share fluctuates between 40 and 45 per cent, a clear sign of despecialisation.

More importantly, in the first five years of the AAs, it was the EU that could benefit much more from agricultural trade. Except for Hungary, all CEECs currently have a deficit in their agricultural trade with the EU. In contrast with the CEECs' exports to the EU, agricultural exports proved one of the most dynamic factors of EU exports to the transforming region. Among many other factors, subsidising of exports contributed to this development.²⁶ For more than one CEEC, export revenues from agriculture are an important source of financing "modernisation imports", "reversed specialisation" may deepen balance of trade problems and substantially narrow the financing of vital imports (machinery, technology, intermediate goods, etc.).

Calculations of the costs of agricultural adjustment have been largely overestimated and did not take into account the different positions of the individual CEECs. First, realistic calculations are extremely difficult to make because we do not know how the reformed CAP will work at the time of accession. Second, the future level and pattern of agricultural production in the candidate CEECs is hard to assess. Third, new commitments to be made in the ongoing world trade negotiations may modify the starting situation. Finally, in the case of a gradual enlargement, which is taken for granted in our scenario, the agricultural costs of accession will only cover the first-wave countries.

Attention should be directed to the fact that the virtual costs of agricultural adjustment can hardly be derived from the two indicators widely used in the EU (share of agricultural output in GDP and share of agricultural manpower in total manpower). First, except for Poland, all CEFTA countries have comparable figures with more than one EU member country and according to these criteria would fit immediately into the EU pattern. Second, and more importantly, the real costs of adjustment substantially

²⁶ At the same time, subsidised EU exports deprived exporting CEECs of some of their important regional markets.

depend on the “modernising capacity” of agriculture in the candidate countries. Countries with a modernised agriculture, where ownership structures, vertical integration, institutional background, high-level experts and market-oriented mentality are available, are expected to show a high degree of flexibility and high and efficient absorption capacity of temporary transfers. In turn, adjustment in those countries without such inputs is likely to cost several times more.

It is evident that the eastern enlargement of the EU requires substantial reforms in agriculture on both sides. Because the EU is the policymaker, efficient adjustment in the CEECs has to be based on reliable information about the direction, speed and scope of the reform of the CAP.²⁷ Even more, further CAP reforms should already take into consideration the agricultural features of the candidate countries. In order to save resources and avoid structural blind alleys, CEECs should be included in the CAP reform well before membership materialises. Also transfers supporting a more efficient agricultural division of labour and reducing future costs – which may emerge after membership in case of a non-adjusted agriculture – have to be envisaged during the pre-accession period.²⁸

Financial Transfers

It is no secret that the CEECs look to the EU as the economic modernisation anchor of the region. Beside free market access and long-term reliability, this anchor role is expected to become manifest in the financing of the modernisation process as well. There is general agreement that all Central and Eastern European candidates will become net beneficiaries of EU transfers, whatever the new structure will look like. At this point, however, the consensus ends and widely different views gain ground. The huge discrepancies reflected by various calculations clearly show the uncertainties and provide a good opportunity for highly politicised assessments. Although no exact calculation can be made at present, some framework conditions can be considered in order to put this issue in the proper perspective.

First, it has to be accepted that the present form of EU transfers will not be maintained. Therefore, any calculation based on the static prolongation

27 This scenario is based on largely stable world agricultural markets. It can, however, not be ruled out that solvent agricultural demand for some basic foodstuffs may substantially increase in the next decade (mainly as a result of higher consumption in the Far East and China). In this case, the present system of cutting back production and withdrawing arable land from production should be fundamentally revised, with tangible impacts on the future of CAP but also on the cost-benefit analysis of enlargement as well.

28 In this context, see Fischler’s proposal for a “pre-accession fund” for agriculture.

of the present system and its application to the new members cannot be regarded as a realistic assessment. Second, the transforming CEECs will be progressing until membership, and are likely to enter the EU with different characteristics than those at present.²⁹ Third, GDP per capita calculations must not be based on the extrapolation of different growth rates. The lesson of most rapidly modernising economies indicates that the catching-up process consists of two basic elements: higher growth rates and currency appreciation. The latter is expected to narrow the present gap in the future at least as much as growth differentials. Fourth, as already mentioned in the agricultural section, it is incorrect and dangerous to throw all CEECs into the same basket. On the one hand, they require largely different sums of transfer (let alone the structure of such transfers). On the other hand, gradual enlargement will distribute the transfer burden for a longer period, so that only part of the potential transfers will appear during the first enlargement. Fifth, any analysis of costs and benefits has to take into account not only potential future transfers but also gains (and losses) already generated. A balanced assessment should not neglect the benefits already earned by the EU in the form of substantial trade surplus, market gains, in many cases market-dominating participation in privatisation, activities of EU-located FDI in the CEECs, etc. Sixth, the assessment of costs and benefits has to consider that this balance is a dynamic one, and short-term costs may be converted into long-term benefits and vice versa. In addition, costs and benefits are likely to differ along sectors, regions and labour markets. Moreover, as the enlargement process cannot be reduced to economic issues, the qualitative (not quantifiable) elements (higher level of influence, security, etc.) have to be taken into account as well. Seventh, the financing of enlargement may be divided into two main sections. Only the direct financing will be translated into transfers to the new members. In turn, the indirect financing that may be required by some present member countries in order to get compensation for the “negative effects” of enlargement (new competitors, shifting of FDI and transfers) increases the total costs of enlargement without benefitting the newcomers.³⁰

One of the crucial issues of financial transfers is timing. At present, the CEECs are confronted with three historical tasks within an unprecedentedly short period. They have to finance transformation, delayed modernisation and adjustment to the EU. Although some of the tasks in these three areas overlap the costs are amazingly high. In historically undercapi-

²⁹ Nevertheless, all of them will remain substantially below the EU average of GDP per capita.

³⁰ In the past, in many cases, the Mediterranean countries have efficiently used the instrument of “blackmailing”. If this practice cannot be stopped, the eastern enlargement may cost much more than the sum to which the virtual transfer to the new members amounts.

talised, medium-developed economies, which in addition are poor in raw materials, the imminent costs can hardly be financed by domestic savings and currently available channels of external borrowing alone. A further discrepancy develops between costs of preparing for membership which have to be paid today and potential (expected) benefits deriving from membership which will become available only in the future. Therefore, the most important issue is *not* to what extent the CEECs will benefit from EU funds once they become full members, but how they could share the costs of adjustment today and in the next years of preparing for membership. Unfortunately, very little attention has been paid until now to the costs of legal enforcement. Policymakers focused on “cloning” EU directives and rules and let the new, EU-style national laws pass through Parliament. However, the costs do not emerge in the area of law-making and translation, but during implementation (e.g. environmental standards, setting up of new institutions, etc.).

At present, the main unilateral transfer for the CEECs is the PHARE programme. It is a highly useful instrument to finance some of the outstanding issues, but definitely short of the resources needed to finance the triple historical task. According to figures from 1994, the potential per capita transfer via PHARE was DEM16 for Hungary. In turn, per capita figures for EU countries benefitting from EU funds were DEM1303 for Ireland, DEM843 for Greece, DEM510 for Portugal, and even Denmark and Belgium received 9 and 14 times more net transfer, respectively, than Hungary (Table 6).

Another hot topic is the absorption capacity of the CEECs. Some calculations, based on “inputs” criticised earlier in this section, argue that, for some countries, the hypothetical transfers would be so high in terms of GDP that the beneficiaries would be unable to absorb them. In theory, this may become a problem. However, at present the situation the CEECs are

Table 6 Net Contributors and Net Beneficiaries of EU Financial Transfers in 1994

Countries	DM per capita	Countries	DM per capita
Luxembourg	4,217	Denmark	143
Ireland	1,303	Italy	-16
Greece	510	France	-29
Portugal	843	Great Britain	-74
Belgium	222	Netherlands	-170
Spain	195	Germany	-63
		Hungary*	16

* memorandum item

Source: Weltalmanach 1996, Bayerische Landesbank.

confronted with is not abundance of funds but just the opposite, the dangerous lack of resources for long-term financing. But even the volume of “absorption capacity” requires an extremely careful and country-by-country assessment. The EU’s reluctance can be understood if we consider the impact of jumbo transfers from Western to Eastern Germany or if we analyse the by far not always efficient use of EU transfers to more than one member country. However, the CEECs must not be evaluated on this basis.

First, all applicant countries are fully aware that they cannot expect German (or even EU average) income levels within a few years. Second, some countries have already shown a high level of absorption capacity. The best case in point is Hungary, which has efficiently absorbed \$16 billion as foreign direct investment. More importantly, each year about \$1 to 1.3 billion flow to this country without major privatisation deals and headline-making green-field investments. The per capita FDI level of about \$1,500 is among the highest figures in the world. Third, the absorption capacity of an economy is positively related to the general level of education, an area in which the CEECs have been and still are clearly above the level of the Mediterranean countries. Fourth, the geographic location of the CEECs in general, and that of the CEFTA-5 in particular, generates multiplier impacts that can only partially be produced by “peripheral countries” in geographic terms. Therefore, investments in infrastructure promise better absorption and higher profits. Fifth, the efficiency of absorbing resources also depends on the social and institutional flexibility of the beneficiary. The transformation, if well managed, may create a better socio-political environment for absorption than a less flexible country with status quo mentality.

Finally, a realistic assessment of the costs of enlargement also has to address the issue of the costs of non-enlargement.

Manpower

One of the most delicate questions of enlargement is the integration of the labour market of the applicant countries into the EU market. First, persistent two-digit unemployment in most EU member countries represents a major barrier to quick and smooth integration. Second, substantial income and wage differences nourish Western European fears of large-scale labour flows from the candidate countries to the EU in general, and to the two neighbouring countries, Germany and Austria, in particular. In consequence, integration in this field will be rather slow, gradual and subject to substantial derogations on the EU side.

At present, labour market policies are managed by the EU member countries. Although the AAs have left open this issue for bilateral contracts, there are only two EU countries which signed such agreements with

the CEECs (Germany and Austria). However, as the labour market conditions started to worsen, these limited possibilities experienced further tightening in the last few years.

Beyond regulation in the accession treaties, prospects for labour flows reveal two strategic issues.

First, even today, there are few, if any, restrictions on the flow of highly skilled labour from Central and Eastern Europe to the EU (and to North America). It is important that highly skilled labour remain in Central and Eastern Europe where it is desperately needed in order to successfully implement modernisation strategies.

Second, restrictions on labour flows from the East to the West are likely to increase the volume of capital flows from the West to the East. The tighter the labour market is controlled, the more capital is expected to flow out of the EU countries to the neighbouring CEECs offering competitive production opportunities. A rapidly increasing share of FDI entering mainly the CEFTA countries is already based on cost advantages. Even more importantly, more and more EU jobs can only be kept if parts of the production process are relocated to the CEECs. In this context, the CEECs become gradually integrated into the European and global network of large (multinational) companies and contribute to higher global competitiveness of the companies involved in this process. This development has a number of advantages for both sides and strengthens the integration process. At the same time, in the medium term, it may also create new tensions within the EU, because not all EU countries will participate equally in the relocation process. Those countries heavily involved in the process will become more competitive than those less or not involved. As a result, the relative competitiveness among present EU member countries may substantially change over time.

During the pre-accession period and also in the first years of full membership the overwhelming pattern will be the flow of Western European (and non-EU) capital to the labour available in the CEECs, and not the old pattern of bringing labour where capital used to be available. For the next years, this is a more favourable pattern of division of labour for the CEECs. In the longer term, however, the EU will hardly be able to avoid strategic answers to two issues. First, the flexibilisation of labour markets, including that of wages, has to be tackled. Second, “decapitalisation” may raise new problems, as investment activities (and future jobs) will increasingly be exported to better locations.³¹

31 This is already the case in Germany, where the upswing of business cycles is accompanied by rather slow growth of investment activities. This is, however, primarily due not to generally sluggish investments, but to the fragmentation of investment activities of leading firms between slow (if any) domestic investment and booming investments abroad.

Sovereignty

Membership of the EU requires the abandoning of national sovereignty in selected areas. Depending on the outcome of the IGC and further integration processes, this part of the *acquis communautaire* may expand further before full membership of some of the CEECs. It is widely understood in the applicant countries that in areas of common policy the pooling of sovereignty is not negotiable. Nevertheless, there are “soft areas” in which a mixture of common and national policy factors coexist.

Although all CEECs regained their national independence only a few years ago, their “sensitivity threshold” regarding national sovereignty is rather different. This is partly due to the different historical experience and heritage deeply rooted in the public perception of sovereignty. In addition, even during the period of Soviet domination they enjoyed different levels of “small freedoms”, including civil rights, economic opening, tourism and social contacts with Western citizens. Moreover, in more than one case, political independence resulted in the (re)birth of nation states. Czech independence dates back to 1618, Slovakia has a record of a few years of national independence, while Slovenia has never been an independent state before. The same pattern holds for most of the successor states of the USSR and for ex-Yugoslavia. Thus in many countries nation-building (and state-building) has to be carried out simultaneously with integration into the global economy and adjustment to the EU. This process will not be finished before negotiations on accession start. Therefore, for some countries (including Poland and the Czech Republic, although for partly different reasons) the issue of national sovereignty may belong to the “hardest core” of domestic policies on negotiations and future membership. In each candidate country, a carefully designed and well balanced communication strategy will be required to convince the society about the costs and benefits of giving up part of the sovereignty. At the moment, this issue seems to be less delicate in Hungary, where historical experience has several times shown the limits of a small country to enforce national interests in the international framework. It is just EU membership which is expected to create interest alliances and thus increase bargaining power in the international arena.³²

32 In the Hungarian case, relations to ethnic Hungarian minorities in the neighbouring countries are a central topic. Once Hungary becomes a member of the EU, some (or all) neighbouring countries with large Hungarian minorities may follow in later waves of eastern enlargement.

VI Why Enlarge?

Until very recently, professional and political discussion about the eastern enlargement of the EU was clearly dominated by a one-sided approach. The obvious (or not so obvious) benefits of the candidate countries and the similarly obvious costs of the EU were stressed. On the rather few occasions when the interests of the EU were addressed, arguments remained in the narrow field of security and “moral obligations”. Economic interests were not identified or they were even denied.

In this short section, some thoughts on the virtual or potential benefits of the EU will be developed.

To start with, part of the benefits have already been enjoyed by the EU. The opening up of the CEECs’ domestic markets generated (and will keep on generating) rapidly growing export flows. Particularly the CEFTA countries became the most dynamically expanding market for EU exports and helped dampen the negative impacts of economic slow-down both in 1993 and in 1996. In 1995, 7.7 per cent of total EU extra-regional exports were allocated in the CEFTA-5 region (against less than 3 per cent five years earlier). The CEECs in general, and CEFTA-5 in particular, became one of the most important trade surplus-generating regions for the EU. Between 1993 and 1995, the EU’s cumulated trade surplus with the ten associated countries amounted to ECU22.9 billion, or 82 per cent (20.4 billion or 73 per cent represented by CEFTA-5) of the total surplus of the EU in its extra-regional trade. Comparing it with about 8 to 9 per cent of total CEECs share in EU extra trade, the difference (i.e. the gain for the EU) is striking.³³

The candidate countries will remain one of the most dynamic external markets for the EU. Their trade liberalisation will have to be completed in the next years. Higher growth will produce higher consumption (both public and private). Modernisation requirements will mainly be met through imports from EU countries. Evidently, potential financial transfers would also mainly flow back to the EU and finance imports originating from present member countries.

Substantial benefits derive from rapid productivity growth mainly in the CEFTA countries and economies-of-scale gains. In addition, the involvement of the CEECs in the network of international sub-contracting is improving the cost structure and the global competitiveness of EU-located companies investing and producing in the region. With low-cost countries

³³ In 1995, CEFTA-5 accounted for 6.7 per cent of the EU’s total extra-regional imports, but generated 32.5 per cent of the EU’s trade surplus.

in its geographic neighbourhood, the EU may become more competitive vis-à-vis North America and the Far East, who have already made extensive use of such a potential in their neighbourhood.³⁴ One of the EU's potential advantages in integrating the CEECs is rooted in the use of skilled labour.³⁵ Direct investments mainly coming from the EU countries reinforce both the presence of EU exporters on the market of the CEECs and strengthen subcontracting networks.

Common rules on European environment are expected to substantially improve the quality of life in the EU countries too. In addition, huge projects to clean and protect the environment in the applicant countries not only offer large markets, but, based on economies-of-scale advantages and on solving special environmental problems, may generate new technologies and create or strengthen Europe's global competitiveness in this highly important future-oriented sector.

One of the key long-term advantages is in the field of infrastructure. Large-scale, regionally designed projects have direct and indirect impacts on trade. Here, the implementation of the projects is likely to produce smaller gains in comparison with the forthcoming benefits covering higher income, more dynamic growth, new sub-regional development centres and increased trade relations both in West-East and in North-South directions. Better infrastructure will reduce delivery times, cut transportation costs and improve global competitiveness for all participants.

Until now, little attention has been paid to the impact of enlargement on the institutional development of the EU. In an adequately reformed framework, newcomers may speed up the decision-making process and, more importantly, create a better balance of power within the enlarged EU.³⁶ Regarding the first issue, the enlarged Union will obtain new impetus, resulting both from new challenges posed by the enlargement, and due

34 In the last ten years, the decline of Western European competitiveness on the global scale was partly due to the low level of reliance on competitive labour. The internalisation of external trade has increased the division of labour among high- and highest-cost countries, while opportunities of outsourcing have not been duly observed. Areas connected to the EU by preferential agreements, such as the ACP or the Mediterranean basin, did not offer the same factor endowment and comparative advantages as some Latin American and most South East Asian countries to the EU's main competitors. In this context, the CEECs seem to be the right partners.

35 It is, however, an open question to what extent shortsighted political interests will be able to use this advantage. Conflicts between the interest of international capital and national labour policies cannot be excluded.

36 In this context, interesting and changing alliances can be forecast. Except for Poland (and partly Romania), all candidate countries belong to the category of small (or smallest) countries. The enlargement will necessarily increase the relative bargaining power of smaller nations.

to fresh, unconventional and innovative approaches by the newcomers in order to find appropriate answers to global and European problems. Concerning the second topic, the applicant countries are expected to shape already, although in an indirect way, the future institutional set-up of the EU, to be worked out by the IGC. A better balance of power between small and large countries has to take into account the accession of mainly small (and one or two medium-sized) countries. In addition, new interest groups and temporary (or lasting) alliances, with substantial impact on the future of the integration process, are likely to develop. In political terms, the weight of Europe can be increased on the threshold of the “Asian century”.

Last but not least, security aspects have to be emphasised. Although they cannot be quantified, it can be predicted that they will play a crucial role in negotiations on accession. Higher security for the citizens in Western (and Central and Eastern) Europe has already become a priority issue in the EU and led to the upgrading of the third pillar in intra-EU cooperation. In this context, candidate countries becoming the new eastern border of the Union have to assume the responsibility of providing the necessary security for the citizens of the Union. In addition, the newly defined concept of security includes social (migrational) and environmental aspects.

When arguing in favour of enlargement, one has to stress the “negative argument”, i.e. what would happen if enlargement were not carried out. On the one hand, non-enlargement would eliminate most of the benefits derived from larger markets, higher growth, modernisation, economies-of-scale and global competitiveness. On the other hand, it would create additional problems and potential sources of conflict which would have to be permanently controlled by the EU – a rather costly undertaking without any prospect of economic benefits and with a loss of competition as a result of diverting part of the available resources from welfare generation to damage limitation.

One of the urgent common tasks of EU and CEECs experts should be a detailed and, as far as possible, quantitative analysis of the benefits of enlargement (for both sides) and the costs which may be attached to non-enlargement. Obviously, benefits and costs are always time-dependent. Therefore, the survey should include various calculations for different timings of enlargement as well.

VII How to Enlarge?

After the political decision on eastern enlargement had been taken, the modalities of enlargement entered the focal point of discussions about the

future of the European architecture. In our view, several questions have to be raised and at least partially answered.

What Kind of Enlargement?

The planned eastern enlargement of the EU needs a careful survey of similarities and differences in comparison with earlier enlargements, particularly with those countries joining the EU with less-than-average performance.

Similar to both Mediterranean enlargements, the present candidate countries look to the EU as their external anchor of security and modernisation.³⁷ As in those cases, these two anchors cannot be separated from each other today either. Long-term security, provided both by the EU and by NATO, is a precondition for predictable economic modernisation. In turn, without substantial economic modernisation no sustainable security can be granted. Brussels (and some member countries particularly stressing the security aspect) has to realise that the highest-ranking goal of security can only be guaranteed if the highest-ranking goal of economic modernisation of the CEECs is given sufficient attention and resources.

Also similar to previous enlargements, the decision on enlargement is largely motivated by political considerations. New aspects and trends of internal security provide additional reasons for this approach. Obviously, it does not mean that economic considerations could be set aside, but they have to be integrated into the global framework of the strategic decision-making process. The more applicant countries are economically prepared for membership, the higher the benefits and the lower the costs and frictions of a politically-driven enlargement will be.

Another similarity is the less-than-average level of economic development of the candidate countries. Their incorporation into the integration framework and their quick development both in the pre-accession and the post-accession periods require a mixed approach. As in previous periods, the EU has to combine market integration methods with instruments of developmental integration. No matter in how many waves and in which country composition enlargement will take place, all new entrants will need a developmental approach. The EU's strategic planning and the distribution of resources have to cope with this reality. At the same time, there are several new features connected with eastern enlargement.

First, the newcomers have to adopt a much broader and qualitatively upgraded set of EU rules and standards than earlier entrants. In part, there

37 In the case of Ireland, only the modernisation anchor played a key role.

is a broader gap between the new requirements of the EU and the present level and problems of development of the candidates. In part, however, this gap can substantially be narrowed by better preparation in various areas, including the fulfillment of the AAs, deregulation, openness, privatisation, and also by a higher level of social and institutional flexibility.

Second, and more importantly, eastern enlargement is likely to take place in a global environment in which the consolidation of Europe's position is a priority task. During earlier enlargements, this issue did not emerge as a major challenge.

Third, eastern enlargement is adding to the EU countries with dynamic growth, world-record productivity increase, substantial future growth potential as well as abundance of skilled and innovative labour. A "banana" of European-type "small tigers", spreading from Slovenia over Central Europe to the Baltics, represents a unique challenge to the EU. It is up to a coherent strategy that rightly or wrongly perceived risks and threats could be dampened and the historical opportunities be grasped.³⁸

Fourth, for the first time in the long history of enlargements, the first wave of eastern enlargement will not extend the EU's external borders to the geographic periphery of Europe. All previous enlargements reached different corners of Europe's geographic periphery.³⁹ As a result, all infrastructural projects reached an end-point determined by the physical realities of the continent. The first round of eastern enlargement will integrate continental countries with substantial transit potential. In consequence, efficiency and multiplier impacts of investments in infrastructure are expected to be higher than in previous cases. If earlier entrants rightly stressed their special role in connecting the EU to other, partly far-away continents,⁴⁰ the Central European candidates all have the right to present themselves as bridges to the East, the South and the North. They all have to (and in reality did already) realise that their transit position, a major strategic advantage, can only be used adequately if they remain open to their neighbours.

38 The scope and timing of these potential gains also depends on whether and how successfully the more developed applicant countries can cope with unique challenges of the second stage of transformation.

39 The first enlargement included the Northwestern part of the continent, the second the Southeastern region, the third the Southwestern one. Finally, the latest enlargement incorporated the Northern part of the continent.

40 Ireland used its North American connection very efficiently, Greece, with much less efficiency, its Eastern Mediterranean role, Spain and Portugal, with high political and low economic commitment, Latin America (and Africa). During the last negotiations, Austria (and Finland) claimed to become bridges to the East – with, to put it mildly, ambiguous Austrian attitudes until now.

What Kind of a European Union to Join?

As policy-taker countries, at present, the candidates have extremely limited power to influence the future shape of the EU.⁴¹ Nevertheless, some of their priorities can be identified.

First, everybody is interested in an open European Union which will not create a fortress Europe but will remain open to the world. Second, the newcomers would like to contribute to build a Europe that is competitive on global markets. Third, all want a European integration characterised by a sustainable internal balance of power. Finally, as the new external borders of the enlarged Union, they want a clear strategy of eastern enlargement and the extension of the integration further to the East, the North and the South, according to a correctly constructed timetable.

How to Define Priorities for Negotiation?

As all candidate countries are small economies with low bargaining power,⁴² they have to develop a very clear negotiation strategy based on detailed cost-benefit analysis. In addition, alternative scenarios have to be designed and high-level flexibility has to be demonstrated during the official negotiations.

One of the most challenging tasks is to select priorities and construct a comprehensive package of priorities. The first phase of this undertaking will be relatively easy, provided that all sectors affected by (and not only interested in) membership of the EU will be addressed and involved in this activity, and also provided that everybody will be in a position to formulate its priorities adequately. The next stage will be much more delicate and will need a clear communication strategy. Obviously, by no means all particular priorities can become part of the list of national priorities. On the one hand, some of the priorities will be in conflict with other part of them. On the other hand, some individual priorities can be integrated into major sets of priorities. Finally, some priorities, although their importance would be acknowledged, may be left out of the negotiation package, either because there is little chance of defending them or because they may weaken other priorities. After selecting the national priorities, the governments of the CEECs have to communicate with all sectors involved why some priorities have not been accepted, and what kind of alternative solutions

41 They may have more power once they are inside the Union.

42 The aggregate GDP of CEFTA-5 amounts to about ECU200 billion at official exchange rates and to about ECU300 billion at PPP rate. This represents 3.1 and 4.6 per cent, respectively, of the EU's total GDP.

are feasible or can be created. A third stage emerges during negotiations, when, as a matter of fact, not all national priorities can be built into the accession treaty. Here, another and very important feedback will be necessary in order to prevent meaningful opposition to EU membership.

The definition of priorities in general, and their scope in particular, depends on the governments' decision regarding the expected duration of negotiations. If the candidate countries are interested in quick negotiations and early membership, they should be advised to limit themselves to a small number of high-priority issues. The more priorities that are presented on the national agenda, the longer negotiations may last. Negotiators must be aware of the fact that the double maximum of quick negotiations and a wide range of priorities to be accepted cannot be reached. Instead, an optimum has to be striven for, consisting of a mix of quick negotiations and the protection of an adequate level of key priorities. This "mix" may easily shift towards the acceleration of negotiations if the domestic and external environment requires it. Also, an opposite trend is possible, if, for instance, the EU were not interested in or prepared for rapid negotiations, or quick adjustment would put too large a burden on the applicant country.

At present, it is extremely difficult to assess the right negotiating position. However, there are some arguments in favour of rapid negotiations and early membership, even if some of the priorities may not be defended. First, part of the necessary adjustment can only be carried out from within the EU. (This is a powerful reason why post-accession strategies are also needed.) Second, in well-defined cases, derogations can be achieved. Third, some priorities abandoned during the negotiations may be successfully represented once the candidate becomes full member. Fourth, early membership may entitle newcomers to have access to EU funds which may compensate for losses deriving from giving up some priorities. Finally, and most importantly, the early timing of accession should eliminate political and economic uncertainties, and change the applicant country's position from "external periphery" to "internal periphery". Depending on the general political climate in Europe at the time of accession, this argument may even gain in strength.

The Sequencing of Enlargement

This issue occupies a central role in the present discussion on enlargement. In principle, there are two basic scenarios: selecting a small group of applicant countries and starting negotiations with all candidates who have a positive *avis*. Both approaches have several pros and cons.

The small-group approach, embracing four or five Central European countries, seems to be justified because the candidate countries are and will

be differently prepared for membership once negotiations open. Three of them (Czech Republic, Hungary and Poland) are OECD member countries, a very clear distinction provided by a highly appreciated international institution. The same three countries are expected to become the first NATO members well before they will be allowed to join the EU. The lion's share of trade and foreign investments are concentrated in the Central European countries, indicating that the international business has already anticipated their accession to the EU. Also they are much more integrated into intra-industry trade and have more developed production and export patterns. Their per capita GDP is much higher than that of other applicants.⁴³ In addition, they have formed CEFTA, a regional free trade area, and started high-level political consultations on regional priorities, including preparation for membership of the EU. On the EU side, the group approach seems to be the only viable option for technical reasons, since it is physically impossible to conduct negotiations with all applicants at the same time.

In turn, this approach also has some manifest handicaps. It may create an *institutionalised* political, security and economic gap within Europe, and generate further differentiation with incalculable consequences. More importantly, it would transmit a doubly dangerous message to those left out of the enlargement. On the one hand, it could give (unintended) support to populists and nationalists within the “dis-preferred” countries and increase anti-European emotions. On the other hand, it could signal to potential dominant powers, both in the region and outside it, that the “dis-preferred” countries are free to be “conquered”.

The “startliner approach” tries to avoid the above danger by preventing any *openly declared* differentiation among the applicants. Also it may fit into the special interest pattern of the present member countries, as almost each of them has a special candidate to be preferred (which, in some cases, may not belong to the first round of enlargement). On the applicants' side, it may provide higher flexibility, for the Central and Eastern European countries could move from one group to another during the negotiation process. This may be particularly important for in-between countries, that, as a result of domestic political transformation, could “upgrade” their present position within a relatively short time (e.g. Slovakia).

However, this approach may have even more problems. While not being able to stop already progressing differentiation based on and fuelled by economic and socio-political realities, it transmits a bad message to the

43 It has been generally overlooked that the “wealth gap” between the EU and Central Europe is not wider than the “wealth gap” between Central Europe and some Eastern and Southeastern European countries, let alone the successor states of the USSR.

more advanced countries. The latter may fear that the time of their accession will be (indefinitely) postponed, as they have to wait for the less prepared countries.⁴⁴ Also, this approach could be used by some member countries to delay enlargement and sustain their privileged status quo position. Moreover, flexibility can easily be used (or even misused) by the EU to play applicant countries off against each other and undermine their anyhow not very strong negotiation position. The most important handicaps of this approach are, however, in the strategic context. First, it would be unable to provide a convenient answer to the challenges Europe is facing at the turn of the century, in security, social, economic and also psychological terms. Second, it could have serious repercussions on the internal cohesion of the Union. Third, it would definitely establish a barrier to more intensive (sub)regional cooperation.

Considering both options, a mixed policy seems to be most realistic. It should be based on two pillars. First, negotiations should be opened with each candidate, and be seriously continued with a few of them, representing the first round of enlargement. Second, and no less importantly, an overall strategy of enlargement should be designed and communicated before starting negotiations. It should include a clear timetable of various waves of enlargement, strengthen cooperation between new members and their non-member neighbours through different instruments (cross-border cooperation, trans-European infrastructure projects) and upgrade financial support to countries joining the EU later.⁴⁵ The establishment of a clear and lasting framework is not only the task of the present members of the EU. Also the prospective in the first wave of enlargement have to be deeply interested in and involved in the implementation of such a longer-term strategy. Already at this early time, responsibility has to be shared between the present and future members of the EU.

How to Communicate Enlargement Strategies?

Both the EU and the applicant countries need a clear communication strategy to prepare the societies for enlargement, explaining benefits and losses and creating a new European identity. Most of these tasks will have to be performed in the next years.

44 This was a well-known phenomenon during the CMEA era. Fears rooted in this period are still vividly remembered in Central Europe.

45 Here, reference has to be made to the decisions on the preparatory work for the Madrid summit in December 1995. Besides opinions on each of the applicant countries, the Council will consider a document that is expected to establish the general framework of the strategy on eastern enlargement. The multi-speed process of enlargement has to be embedded into this framework.

It is, however, extremely urgent to shape a credible communication strategy for the EU. While politicians regularly state that the enlargement process cannot be reversed, concern and fear about enlargement is growing in the societies of many EU member countries.⁴⁶ In order to get the necessary social support for enlargement, the negative arguments based on damage limitation have to be quickly replaced by positive arguments emphasising the political, security and economic benefits the EU has already gained and is expected to gain from eastern enlargement.

The Role of Regional Cooperation in the Enlargement Process

Regional cooperation, mainly in the framework of CEFTA, has three important tasks to be fulfilled.

First, a more comprehensive and better coordinated pre-accession strategy is required. Although the potential of sub-regional cooperation will get the most important impetus from joining the Union,⁴⁷ above average growth of regional trade can be registered already in the preparatory stage. Emerging different patterns of specialisation started to create favourable environment for intra-industry trade. Also FDI can be considered as an important impetus to regional cooperation. Official consultations on regional and EU-related issues have become common practice.

Second, special attention should be devoted to those neighbouring countries which are unlikely to become members in the first wave of enlargement. For obvious security and economic reasons, contacts have to be developed before accession, and the CEFTA's openness to the other candidates has to be further enhanced. This is an indispensable precondition of making use of the advantageous geographic transit position of Central Europe. Already in the present stage, this transit role should be strengthened by the presentation of joint projects starting from small-scale cross-border cooperation deals to be financed by the Multiphase Programme to largest-scale trans-European networks. Also, openness and rapidly developing contacts may accelerate the process of further eastern

46 It has to be noted that fears can be grouped into two major categories: security and economics. The latter includes both growing external competition (commodities and labour) and the diversion of resources (FDI and transfer flows). While the less developed countries of the EU emphasise their economic concerns, geographical neighbours fear impacts on their internal security. Austria is the only country experiencing both impacts, which, in part, may explain the rather hostile attitude of this country, bordering on no less than four candidate countries, to (early) enlargement.

47 As a case for comparison see the booming of relations between Spain and Portugal after membership. It has to be added that the present level of CEFTA cooperation is both quantitatively and qualitatively much higher than that between the two Iberian countries before membership.

enlargement, keep the time of the first enlargement as short as possible and reinforce the temporary character of some of the new external EU borders dividing Central Europe from its eastern, northern and southern neighbours. In addition, good neighbour relations, including the adequate treatment of minority issues, are a major contribution to regional security, a key qualifying element of (potential) EU membership.

Third, new areas of cooperation should be carefully envisaged vis-à-vis the EU. Evidently, one key issue is the more coordinated preparation for membership. Although each country will negotiate on its own terms, merits and handicaps, even in the case of the most careful preparation, each of them will have a weak negotiating position. In the optimal case, first-wave candidates should support each other to achieve better results at the negotiating table. However, if this turns out to be wishful thinking, at least, as a minimum requirement, the undermining of each other's position has to be avoided.⁴⁸ A second area of possible cooperation could be the designing of regional infrastructural projects as a useful contribution of the EU to the success of pre-accession strategies. Another issue to be dealt with could be the common thinking about the creation of a special fund for the countries belonging to the first wave of eastern enlargement. Previous enlargements regularly created a new fund tailored to the specific needs of the newcomer(s). Moreover, such a fund might dampen the fierce fighting about the redistribution of EU funds and offer an opportunity to the net contributing countries to redirect (relabel) their support to be paid into the central budget of the EU. Equally important and even more timely would be the development of a joint communication strategy towards the Western European societies. Taking the group approach for granted, the first wave of eastern enlargement will affect more than one country, and most probably, a more or less homogeneous region. Thus the group approach will be based on regional considerations. Central Europe, by anticipating this approach, should already start a communication strategy emphasising the regional importance and aspects of enlargement.

VIII Concluding Remarks

Membership of the European Union by Central (and probably later Eastern) European countries is one of the most important strategic tasks of

⁴⁸ In this respect, the story of the negotiations of Spain and Portugal, on the one hand, and those of Finland, Sweden (and partly Austria), on the other hand, with the EU are extremely enlightening. The first provides lessons on how not to negotiate, while the second delivers useful inputs on how to achieve in joint action something that would be unlikely to be achieved in separate deals.

Europe at the turn of the century. It coincides with other strategic decisions to be made on the future architecture of the Union. In all cases, two overriding priorities have to be considered:

- (a) the security of the continent, which cannot be sustained without rapid and predictable modernisation of Central and Eastern Europe, and
- (b) the strengthening of Europe's place in international politics and the global economic system.

Following the positive political decision on enlargement, the no less important (strategic) answers on when and how enlargement has to be implemented have to be formulated on the basis of these two priorities.

As security and competitiveness are not static but highly dynamic, the timing of enlargement (including its pre- and post-accession periods) seems to be crucial.

More than seven years ago, an ex-secretary general of an ex-great power told to another ex-secretary general of another ex-country that history would punish those who are delayed or delaying things to happen. At present, this remark is no less timely. However, it is no longer related to Central and Eastern Europe, but to the more developed and (still) luckier part of the continent.