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RESULTS FROM THE RESEARCH PROGRAMME "PREPARITY": A POLITICAL AND ECONOMIC ASSESSMENT

EDITORIAL

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In view of the geographical vicinity and a common cultural and historical heritage, Austria maintains relatively close economic ties with the countries in East-Central Europe, which have become even much stronger since these countries opened to the West in the early 1990s. In many instances, the new relations could pick up on tradition and experience from the past. The enlargement of the EU towards countries in this area is therefore of crucial interest to Austria. No other EU member state is drawing as much benefit from the opportunities offered by the full integration of these countries, but no other is affected to the same degree also by the economic adjustment, this requires. In the light of the political and economic perspectives, the step (or possibly the several successive steps) towards enlargement calls for a strategic response from Austria which in principle is bound to be positive.

The enlargement as envisaged and currently negotiated in substance is in more than one regard without precedence. At least 15 countries in Central and Eastern Europe (plus Cyprus and Malta) may claim membership in the medium term. Such a perspective constitutes, in the first place, a major challenge for the operational capacity of the EU institutions. The prospective need for reform in this regard has not yet been finally met at the political level.

In the foreseeable future, the state of economic development of the accession candidates will on average remain substantially below that of the present member states. The tradition of a market economy had been interrupted for decades by the communist regimes, in some countries it had never really existed. Some of them are potentially large exporters of agricultural products, thereby exacerbating the already precarious situation of the Common Agricultural Policy. On present rules, all of them would become net recipients of substantial structural adjustment subsidies; this, in any case, has a strong impact on each of the present members' position in the internal financial burden sharing.

Despite or indeed because of the historical singularity of the enlargement project that does not allow any straightforward reference to historical precedents, political authorities in the EU institutions as well as in the member states and, of course, in the candidate countries are highly interested in the forward-looking analysis of likely framework conditions and consequences, of the different options and their inherent potential. By now, the consequences of eastern enlargement constitute a vast area of research going well beyond the purely economic considerations.

The focus of the economic analysis is on the possible gains in productivity and income deriving from a better resource allocation within the Single Market and from the co-ordination of economic policy, but also on the necessary structural adjustments on both sides of the former divide between East and West. Such adjustments are a prerequisite for the expected gains to materialise. The issues involved are changes in local business conditions and markets, cross-border co-operation and the exchange of goods and services, gains and losses for different economic sectors, but also mobility of production factors such as capital and entrepreneurial capacity, and notably the free movement of people and labour.

Economic theory has developed a number of propositions on the possible effects of an extension and harmonisation of an economic area. There is widespread agreement on the ultimately positive effects also in the economic domain, quite apart from the political

Empirical and macro-economic analysis as a basis for structural and regional policy decisions

advantages. Co-operation in economic policy matters, common rules for markets, a similar institutional infrastructure and the large scope for the new members to catch up will stimulate and secure efficiency and performance on both sides. If proving successful, the integration process will enhance Europe's overall competitiveness vis-à-vis other parts of the world.

Against the background of these theoretical hypotheses, empirical research has investigated well before the current enlargement process into the perspectives of a larger internal market. It has already analysed in depth the impact of the Eastern countries' opening to the West in the context of the institutional rapprochement so far. Part of the effects obtained from the opening process up to now will be continued and intensified by the step of enlargement. However, some other options and problems will newly emerge, such that the experience from the past cannot simply be extrapolated to the present case.

Often, the analysis and findings of empirical economic research limit themselves to macro-economic relations. They do not sufficiently differentiate between regions and sectors as to allow solid policy conclusions to be drawn. In this regard, the prospects for the regions close to the present EU frontier in central Europe are of particular interest, not only for Austria, but also for Germany and Italy facing a similar geographical situation. They are, of course, of even greater interest for structural and regional policy in the accession countries. Given the instruments the EU has developed to foster regional coherence and structural competitiveness, realistic results can only be expected from an analysis going beyond the macro-economic aspects and explicitly including the sectoral and regional situation on both sides of the EU border.

Within the framework of the preparations for enlargement, the EU is supporting empirical research in this area, by co-financing the INTERREG IIC common initiative. In that context, the Austrian Institute of Economic Research had been given the mandate to steer the project "PREPARITY – structural policy and regional planning in the EU border regions in Central Europe in preparation of EU enlargement". Stretching over more than four years, work has been shared between WIFO, two German (Ifo Dresden, GEFRA Münster) and one Italian institute (ISDEE Trieste); substantial expertise has also been provided by research teams in the accession countries.

The mandate for the whole project had been given by the Austrian Federal Ministry of Economics and Labour, the Austrian federal states of Burgenland, Carinthia, Lower Austria, Salzburg, Styria and Vienna, the German Federal Ministry for Economics and Technology, and the Italian regions of Friuli-Venezia Giulia, Veneto, Marche, Abruzzo and Molise. "Preparity" was concluded in November 2001.

Detailed reports are available on the numerous studies of particular sectoral or regional aspects – such as on the effects on foreign trade markets, foreign direct investment, services, small and medium-sized enterprises, geographical shifts of production. Special emphasis has been given to the sensitive issues concerning agriculture and the deregulation of labour migration.

Findings from structural analyses disconnected from the corresponding macro-economic framework could be misleading. Such a framework has therefore been established on the basis of an international simulation model capturing the interactions between macro variables and structural change.

In this issue of *Austrian Economic Quarterly*, the major aspects and findings are presented in concise form. Fritz Breuss, in a [WIFO Working Papers](#), tried to quantify the macro-economic potential of enlargement on the basis of specific assumptions concerning date and scope of the first accessions. Peter Huber is dealing with the impact on the [labour market](#). Finally, the articles by Peter Mayerhofer and Gerhard Palme review key effects upon economic [sectors](#) and [regions](#).

The investigations into regional and sectoral structures broadly confirm the macro-economic assessment; however, they clearly distinguish between privileged and disadvantaged economic sectors, thereby shedding light on potential problem areas both West and East of the former divide. In this way, they should give useful guidance for policy already before enlargement.

The empirical research results presented here come as a further support to the presumption that, assuming appropriate political and economic framework conditions, eastern enlargement will most likely yield net economic benefits to both sides in the medium and longer run, if not immediately in the very short term.

In the candidate countries, the pronounced disparities between favoured regions (large cities and areas close to the present EU border) and disadvantaged peripheral ones may widen further during the integration process. Adjustment costs are also foreseeable for structurally weak areas dominated by mining or manufacturing activity on a narrow base.

The present EU member states should expect that cross-border investment and co-operation will intensify. On the whole, firms will more likely be competitive, the more they concentrate on producing goods and services of high value added, using highly-qualified human capital. Pursuing an active strategy in this regard will offer greater chances for success than a defensive reaction pattern. Nevertheless, in some instances it will be useful to provide for transition regulations, particularly as the size of the impact of migration and commuting on the labour market is unknown. The analyses also signal growing problems and needs for adjustment in the agricultural sector.

In the border regions of Austria and Germany the need for structural adjustment will be greater, the more the economy has been dominated by labour-intensive sectors and branches. Small-scale manufacturing and service production, while on the whole deemed competitive, may nevertheless come under greater pressure in sectors such as construction, trade and transportation.

The empirical investigations carried out assume that the political and economic framework conditions for the historical endeavour of EU enlargement can be shaped in an appropriate way. However, this assumption can at present not be taken for granted. The Treaty of Nice, while clearing the way for the conclusion of the accession procedures, does not in the eyes of most observers solve the institutional problems arising from enlargement before the actual event. Moreover, negotiations on the presumably most important and most difficult chapters of the accession process have not yet been concluded, and even the likely outcome can in some cases be hardly anticipated. This is the case for the future conduct of regional and structural policy, as well as for agricultural policy and the transition regulations for the free movement of people and labour.

A great deal will also depend on whether macro-economic framework conditions will be set appropriately. This concerns the exchange rate regime and a carefully designed road map towards monetary union, but also wage and social policy as well as budgetary policy.

An economically successful accession is possible, but will not be achieved automatically. Candidate countries are largely free to determine their accession strategies, and they themselves are largely responsible for creating favourable or less favourable conditions for their integration into the EU proving successful within a short time. The experience of previous enlargements, if obviously of smaller scope, clearly shows that success may either arrive quickly (as in the case of Spain and Portugal) or, due to inadequate political circumstances, only after severe adjustment crises (examples are not only the special case of German re-unification under inadequate political conditions, but also Ireland benefiting relatively late, but eventually all the more strongly from membership, and Greece).

In this way, both the macro-economic and the structural simulations of accession scenarios should be taken as reflecting the potential for developments under certain, essentially favourable conditions, and not as unconditional forecasts.

The studies presented may contribute towards facilitating the relevant political decisions, notably in the member states Germany, Austria and Italy, situated at the EU border. It is indeed in Germany and Austria that the somewhat paradoxical phenomenon is observed, whereby the economic and probably also the general political analysis identifies these two countries as potentially drawing the largest benefits, while nevertheless the population shows more reservation and scepticism than anywhere else. The explanation for this puzzle probably lies in the fact that the sectors and regions being net gainers (the overall majority) state their case less strongly than those groups coming under severe pressure to adjust. It is a well-established experience of political economy that the prospect of a gain mobilises less political energy than the fear of a loss of equal size. The political authorities are called upon to take a decision in favour of the overall public interest, and to create acceptable conditions in those areas, where difficult adjustment will be inevitable.

Political and economic framework conditions for EU enlargement