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POLITICAL AND ECONOMIC PERSPECTIVES OF THE EU EASTERN ENLARGEMENT

“Enlargement is not only about transfers and narrowly defined economic benefits. Eastern enlargement is an essential pillar in Europe’s post-Cold War architecture” (Baldwin – Francois – Portes, 1997, p. 128). • The breakdown of the Communist regime and the predominance of the Soviet hegemony that had prevailed in Eastern Europe for over 40 years presented Europe with the opportunity to overcome its deep political and economic divisions. Facing considerable obstacles, the transition countries in Central and Eastern Europe began to establish their own democracies and market economies. From the very beginning, most of these countries considered the possibility of pursuing a complete integration with the political and economic institutions in western Europe, and found this to be both logical and tempting. For western Europe, the focus of interest lay in expanding economic relations, which were far from having reached their potential beneficial level because of political circumstances; and it lay in establishing a close political relationship, which would provide guarantees for both peaceful co-operative ties and an increase in security.

All European countries in which democracies and market economies are firmly established have the option of joining the European Union. Ten Central and Eastern European countries (CEEC) have already applied for membership. For five of these countries, the Czech Republic, Hungary, Poland, Slovenia and Estonia, membership negotiations have begun. And although more candidates could apply for membership in the near future, it looks as if the countries of the former Soviet Union, with the exception of the Baltic States, will not. At the same time, negotiations for admitting Cyprus to the Union have begun (the implications of EU integration of Cyprus will not be discussed in this issue).

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A HISTORIC CHALLENGE

The goal of enlarging the European Union to the east is a historic challenge in that it provides a possibly fleeting opportunity for establishing a politically and economically united Europe.

Historically, the step toward enlarging the European Union to the east is unprecedented; for one, because such close institutional ties between western Europe and the CEECs as a whole never existed. Also, the decision to join the European Union was voluntary for the countries applying for membership, most of which endured the rule of the Habsburgs, the Czars or the Ottomans for long stretches of time. The degree of integration in the European Union is in many ways higher than it was during the Austro-Hungarian Monarchy. On the other hand, the sheer number of possible new members from Central and Eastern Europe, if admitted to the Union, poses a very difficult challenge, although for now, the group of prospective member countries is still manageable. The expansion of the European Union to the south, as it took place for Greece in 1981, and for Spain and Portugal in 1985, is not comparable to the eastern enlargement in either magnitude or degree of difficulty. This is because the recent candidates lag farther behind in their economic development as well as in their lack of experience in navigating market economies. In recent years, however, these gaps were to some extent closed, in part because of the prospect of joining the Union.

The European Commission has thoroughly examined the political and economic implications of eastern enlargement, and has depicted them in statements accompanying the various applications for admission to the Union and in Agenda 2000. The Commission has then drawn its own conclusions (*European Commission, 1997*): the enlargement to the east requires important adjustments, which will not just affect the applicants for EU membership. The European Union, the Economic and Monetary Union and the participants in the domestic markets will have to adapt as well, notably by reforming the institutions of the European Union. The European Union will not have to adjust to its new eastern European members, but it must create the conditions that will allow it to function and develop properly, even as the number and the heterogeneity of the member countries increases. This is a major problem, considering that current member countries already disagree on the Union's goals and priorities, which makes the negotiations with new applicants all the more difficult.

The agenda surrounding eastern enlargement is not only defined by the interests of the European Union, its members and of the candidates, but also by exogenous factors.

For one, Russia's political situation influences the speed with which the enlargement project proceeds. The events in other countries, such as in the countries of northern Africa or Turkey (Turkey also matters in dealing with the Cyprus conflict) impact on the enlargement process as well.

The world economy can also play a role, in particular the conditions of competition between the large economic regions, the level of capacity utilisation and the underlying conditions of the globalisation process (e.g., international agreements, such as the agricultural agreement initiated by the World Trade Organisation). In addition, the strategies of transnational firms and of holders of capital influence Europe.

So far, the macroeconomic development in western Europe has not been affected by the eastern enlargement negotiations, but the state of the economy could have a large influence on the speed of the negotiation process. In addition, the different political priorities of the governing parties and the coalitions formed between different EU countries matter as well.

LACK OF CERTAINTY ABOUT THE EFFECTS OF ENLARGEMENT

It is not enough that political history fails to provide a relevant set of episodes that might guide this round of enlargement; economic models, too, are inadequate in providing insight into the complicated and unique process of enlargement. This does not mean that history does not have anything to teach us about some important aspects surrounding the enlargement, nor can one do without a well-argued line of thought or the quantitative estimates based on economic models.

The main analytical models that have been applied to issues relating to eastern enlargement have the disadvantage of relying either on a completely ahistorical framework, as provided by general equilibrium models, or by models using historical variables, such as time series. Time series models cannot capture structural breaks, which is a problem because the current situation could be characterised as a structural break. Both types of models are based on the implicit neo-classical assumption that integration can be described as a win-win option. By definition, these models do not allow for the integration of some countries into an economic region to have no benefits, or to fail. However, one could think of a number of realistic circumstances under which integration could be an economic failure. In this context, not even eastern Germany and the specifics surrounding its integration can serve as a persuasive example. Economic models should therefore be used

only as a point of departure for further economic and political arguments.

The economic literature has recently provided a series of approaches to a more realistic analysis of eastern enlargement. The literature addresses not only the validity of the basic assumptions in theories of integration, which predict positive overall effects associated with an enlargement of the area of integration. These effects are generated by an increase in competition and by a higher degree of specialisation. Some authors also distinguish between the effects of large versus small areas of integration (*Casella, 1996*), while others focus on integration effects when a region with a more developed economy accepts equally or less developed economies into its trading bloc.

Because of its neo-classical assumptions, economic theory does not need to rely on integration in order to provide a theoretical explanation for convergence. Growth theory contributes to our understanding of how the accumulation of capital and knowledge propel endogenous economic growth. Other models show that both increases in welfare and the process of convergence can be hampered by imperfect competition or by entry barriers to markets.

More ambitious analyses of eastern enlargement are taking sociological and political factors into account. *Baldwin – Francois – Portes (1997)*, for example, base some of their estimates on the assumption that the eastern enlargement of the European Union will decrease the risk of investment in the CEECs, thereby making these locations more attractive to investors.

Still, the answers to the question of how eastern enlargement will play out remain at best controversial, even those focusing solely on economic calculations. This is due to the restrictions and the lack of precision contained in economic models of integration. It also stems from the difficulty of integrating both political and economic factors into an analysis of eastern enlargement. Next to the necessity of setting medium- and long-run goals, the lack of certainty in predicting the prospective end result of integrating the applicants into the Union constitutes the most important political obstacle to enlargement, causing widespread political resistance, not only in the European Union, but in some cases in the prospective member countries as well (*Von Hagen, 1996, p. 2*).

The most important uncertainties concern the following issues:

- the priority given to a widening, as opposed to a deepening, of the European Union,
- the distribution of welfare gains,
- the political co-ordination and decision-making process in an enlarged European Union,

- the role of the modern information society in the decision making process,
- “social capability”: a society’s ability to absorb and apply new knowledge,
- the role of expectations and unrealised expectations; and
- the choice of timing (lack of precision in the reference scenarios: no admission or the delay of admission).

THE PRIORITY GIVEN TO A DEEPENING VERSUS WIDENING OF THE UNION

The motivation for the eastern enlargement project is evidently not just based on economic considerations. Overall, political goals may be more important, although they can be reached more easily if their economic benefits are clear. Economists believe the enlargement to be beneficial under certain conditions, and show that in the medium and long run, both the countries joining the Union and the EU itself will reap economic gains.

“Eastern enlargement can only be successful if a majority of member countries do not consider it to be a zero-sum game, if they take into consideration the specific medium- and long-run welfare gains of all participants of the enlargement process, and if they have a good understanding of the European Union as an entity promoting order and peace” (*Kreile, 1997, p. 235*). One could add another motivating force behind the eastern enlargement project on the part of the current member countries: the possible increase in clout of the Union in the world economy and in world politics.

A quantitative analysis of the political and economic considerations surrounding the enlargement can only be limited in scope. Occasionally, a peace dividend enters these calculations, but its assessment covers a wide range of possible values. This may explain, at least in part, the sometimes incongruent general statements made in favour or against enlargement.

The political analysis of the eastern enlargement is frequently tainted by concerns that the increase in the Union’s heterogeneity could hinder a deepening of EU institutions in the future. As a result, political forces favouring the co-operation of a large group of countries that remain highly independent favour the Union’s eastern enlargement. On the other hand, the forces focusing on deepening the Union are regarding the enlargement agenda with scepticism, preferring instead to root for issues relating to the enlargement of the Monetary Union, the co-ordination of tax policies, the European Union budget, as well as defence and foreign policies.

The conflict between the deepening and the enlargement of the Union is not likely to erupt in all of these aspects. But it seems as though it will be necessary to define both optional areas of integration and some core issues important to all members, such as the *acquis communautaire* of the domestic market.

DISTRIBUTION OF WELFARE GAINS

The current models are only able to provide a very rough estimate of how the welfare gains stemming from the enlargement will be distributed between the member countries and the countries joining the Union, but also between specific countries, regions, sectors and socioeconomic groups. As a result, comprehensive studies of the enlargement frequently omit analysing these aspects.

Due to the size of the Union relative to the eastern countries, we can expect the enlargement to generate larger effects in the countries joining the European Union. Furthermore, the assumptions of the gravity models imply that the welfare gains will be relatively larger in the countries neighbouring CEECs than in the countries at the western and southern European borders. The assumptions made in gravity models and their implications for economic relations are likely to be applicable to political relations as well.

Specific social groups caring more about losing out to other groups than about the expected absolute gains of enlargement could increasingly fuel political resistance to eastern enlargement (*Baldwin, 1989*). In this case, the lack of precision in assessing the future regional and sectoral structure of an enlarged Union represents a political handicap.

POLITICAL CO-ORDINATION AND THE DECISION-MAKING PROCESS IN AN ENLARGED EU

The effects of enlarging the Union on political co-ordination and the decision-making process are equally uncertain. Both the number of members and the heterogeneity of the Union will increase significantly. The most obvious, but largely ignored, effect consists in a disproportionate expansion of the Union's bureaucracy, stemming for example from the need to provide translations in more languages. With a less-than-appropriate institutional framework, heterogeneity could lead to inefficiencies. It could also keep the Union from moving forward, and may even call into question the achieved degree of integration.

On the one hand, economic models frequently fail to capture the positive effect stemming from the co-ordination of economic policy decisions. Ideally, these positive effects

stem from both a decrease in costs and an increase in the efficiency of political governance, for example in the areas of employment and environmental policy-making. On the other hand, however, there is also a danger of delaying decision-making processes and of making suboptimal compromises.

THE ROLE OF THE MODERN INFORMATION SOCIETY IN THE DECISION-MAKING PROCESS

Generally, economic models emphasise direct investment and trade flows, but fail to recognise the new parameters of today's modern information society. All over the globe, knowledge is more accessible, more exhaustive and cheaper than ever. And yet, it is only the access to restricted "insider" information, such as the type of information that generates and feeds political processes, that is most important in order to successfully influence the course of political decision-making and to build valuable coalitions and compromises. The possibility of accessing restricted information can be most beneficial, but at the same time, it eludes quantification.

"SOCIAL CAPABILITY": THE ABSORPTION AND APPLICATION OF KNOWLEDGE

The ability of utilising scale effects and innovations as a result of increased competitive pressures associated with integration will depend on more than just economic capacities. It is also related to sociological and political factors, which *Abramovitz (1986)* summarised as "social capability", and can be defined as a society's ability to absorb and apply new knowledge.

Keeping track of macroeconomic and structural indicators to evaluate the economic development of the prospective members relative to the European Union is indispensable, because such indicators provide a first clue to the economically appropriate timing of membership to the Union.

The economic effects associated with integrating countries at a lower economic level of development, such as the CEECs, are not only determined by the gaps in technology, income or productivity. The existence of a preferably large pool of capacities in education, in entrepreneurship and infrastructure, not to mention the ability to undergo structural change is perhaps even more decisive. In the worst of all possible scenarios, countries that failed to show an appropriate degree of economic and political maturity would nevertheless join the Union. And this would backfire, not only because these countries would become a burden to the Union, but also because they would run the risk of reverting to a lower level of development.

There is no other explanation for why the progress made by Portugal, Spain and Greece was very different, at least in the first ten years after they were admitted as new members in the course of the southern expansion of the European Union. Portugal and Spain more were able to take advantage of their EU membership than Greece, in spite of having joined under very similar initial economic conditions. These results are compatible with *Olson's* (1995) work on the role of adaptive and fossilised institutional structures.

The assumption that all countries admitted to the Union in the course of the eastern enlargement will be able to equally capitalise on new growth incentives can therefore be justified only out of lack of available alternatives. The socioeconomic factors explaining why some of these countries had already reached a high level of economic development before World War I, such as the Czech Republic, while others were left behind, could still be shaping economic development after a long period of time.

THE ROLE OF EXPECTATIONS AND UNREALISED EXPECTATIONS

Economic models frequently fail to take into account the role of both expectations and unrealised expectations. The anticipated enlargement of the European Union has been contributing to an increase of investment in the CEECs. It is difficult to predict the consequences of unrealised expectations in the advent of the candidates being denied membership within a reasonable time frame, but they should not be ignored.

CHOICE OF TIMING: THE LACK OF PRECISION IN THE REFERENCE SCENARIOS

All studies of the effects of enlargement presented in this issue suffer from a lack of precision in their way of defining the initial scenarios. These scenarios are inadequate in their description of what we can expect to happen in the case of no admission or a delayed admission to the European Union (the consequences of the choice of timing).

Most studies, including those of WIFO, consider the Union to fit the category of an improved free trade area, and assume that the status-quo of the Union, including its Europe Agreements, would be maintained if the enlargement did not take place. These assumptions are justified in that a series of countries were able to rapidly overcome the setbacks in their economic development after the end of World War II, although they did not join the existing integration blocs, as it was the case for Austria for an extended period of time.

In 1997, the GDP of all five applicants to the Union, evaluated at purchasing power parities, amounted to 6 percent of the GDP of the 15 EU members. Projections widely used in other studies on economic convergence (*Richter et al.*, 1998) are all based on the assumption that the prospective members' GDP will grow at twice the GDP growth rate in the 15 EU countries for the next twenty years (at 4 percent versus 2 percent per year). The increase in GDP in the prospective member countries corresponds to 15 percent of the change in the GDP of the 15 EU members. As such, this magnitude represents a demand boost for the EU that cannot be underestimated. When including the second group of applicants to the Union (Slovak Republic, Latvia, Lithuania, Croatia, Bulgaria, Romania) into these hypothetical calculations, the results suggest that the "growth contribution" of the group of new members amounts to roughly 20 percent of the GDP growth rate of the 15 member countries of the Union.

However, when making a decision about whether to admit new members to the Union, the crucial question is what the economic outlook of the prospective member countries would be if they did not join the EU within a reasonable time frame. After all, the European Agreement already lays the groundwork for a more intense labour division in the future, by encouraging free trade for manufacturing goods, allowing for direct investment and the related transfers of capital, adapting commercial law and fostering political co-operation in various sectors.

Considering the rather uncertain political situation of many prospective member countries and a saturated world economy with protectionist tendencies, the failing of enlargement negotiations could well have unpredictable economic and political consequences. The opportunity costs of non-admission to the Union could be much larger than one would expect from the difference between admission and status-quo (*Szekely*, 1997, p. 173)

As a result, political considerations surrounding the eastern enlargement dictate that it make use of both fairly substantiated economic views and imponderable political hypotheses. The uncertainty concerning both the Union's future development and the prospective effects of the enlargement make the admission process more difficult.

Political problems could be overcome more easily if the economic benefits of enlargement were more clear-cut. But the economic benefits themselves may be strongly influenced by the extent to which the European Union is able to broaden its institutional structure even before the eastern enlargement, in order to ensure efficient decision-making and a well-balanced settlement of various interests.

It would be in the interest of the Union not to rush the timetable for its eastern enlargement to avoid inflicting dam-

age to the cause of European integration. This conclusion was drawn because the current members of the Union could not yet agree on necessary reforms, and because the population in the member countries has shown reservations toward the eastern-enlargement project, and to a certain extent even toward the Union itself.

THE SIGNIFICANCE OF EASTERN ENLARGEMENT FOR INDIVIDUAL EU COUNTRIES

The political decision over both the time and the scope of the Union's eastern enlargement is to a large extent marked by the specific interests of individual EU members. After all, admitting a prospective member to the Union requires the unanimous vote of all its current 15 members. The prospective member countries do not have the same leeway for manoeuvre, although they are granted temporary exceptions to the current rules.

Shaped by the drive to uphold national interests, the individual members' position toward the eastern enlargement of the Union is marked by four sets of factors:

1. the political assessment of prospective member countries, including how they measure up as potential coalition partners, which in turn depends on the existence of overlapping or diverging interests;
2. the position of its own economy in the division of labour of an extended domestic market;
3. the position relative to the EU internal mechanisms of redistribution through the Union's budget, especially in aspects regarding to the Union's structural and agricultural policies; and
4. the opportunities and dangers in the regions with a border to prospective member countries (because this aspect is particularly interesting for Austria, it will be elaborated at the end of this contribution).

The first point addresses not so much economic policy as a series of foreign- and security policy considerations. For example, some have argued that the eastern enlargement would shift the focus of the European Union to the East, thereby further strengthening Germany's position. And this, they argue, would not be a positive development, especially for France. If the eastern enlargement should come to pass, new coalitions with the current EU members could emerge. These coalitions would be underpinned by the joint interests of smaller countries and the common concerns of countries with the same geographic characteristics, as expressed in environmental and infrastructure policies.

The division of labour emerging from the transition of the current domestic market to an enlarged community has

been repeatedly examined from an economic perspective, especially with respect to the consequences for numerous sectors of the economy.

With regard to location, it seems as though most prospective members are not competing with the EU countries characterised by a high productivity, but they are an alternative to the western European economies with a below-average productivity, in particular in the western and southern periphery. A series of important products from these countries will compete with the candidates' products or locations, in particular in industries producing textiles, clothes, shoes, steel, ship building, automobiles, and chemical products. Although this development is on the way as a result of regional free trade agreements, it would be accelerated by the complete opening of the Union's domestic markets, in particular of the Union's more sensitive sectors.

As a result, Portugal and Spain will be rather reluctant to make concessions to these markets in the course of enlargement negotiations, while they can afford to be more generous in questions of immigration. The northern member countries take the reverse position, lending support to proposals for an accelerated trade liberalisation in combination with a more restrictive stance toward migration issues. In all likelihood, these measures would be blocked by the southern member countries (*Von Hagen, 1996, p. 9*).

At an early stage of the debate over eastern enlargement, it became apparent that the prospect of giving the candidates access to the Union's transfer system would probably constitute the most sensitive issue. First estimates of enlargement-related financial requirements under the current rules of the Common Agricultural Policy (CAP) and cohesion policy (Structural Funds) were made. These estimates, in combination with the candidates' agricultural potential and economic level of development, led to the realisation that the transfer issue presented an almost insurmountable hurdle.

There are several factors explaining why the debate has since calmed down. For one, in agreements made under the auspices of the World Trade Organisation (WTO), the Union has made a commitment to reduce financial support for its agricultural sector within the coming years. Also, the convergence process at work has brought many particularly supported regions so close to the EU average, that further financial support could be decreased even without consideration of an enlargement to the east.

At the same time, it became apparent that the Union would be overly strained if the current rules applied. The candidates' price level for agricultural products would increase to the much higher level prevalent in the EU, which

would trigger both inflation and distribution-related conflicts in the CEECs. Overly generous transfers associated with the Union's regional structural policies could have similar detrimental effects in the recipient countries. This is the case because the necessary co-payments would overburden public sector budgets, and could lead to inefficient investment, to projects based more on their prestige value than on necessity, and possibly to an increase in inflation.

The Union is currently reviewing its system of regional structural aid. It seems particularly appropriate to examine past and current eligibility criteria in the light of a possible enlargement to the east, and to critically evaluate them before making the decision to keep them. This implies that differences in the candidates' absorption capability should also be taken into account (*Inotai – Vida, 1998, p. 101*).

However, it would be advisable not to wait for the candidates to join the Union to begin providing them with funds aimed at fostering structural adjustments and supporting them in the "pre-admission" phase. This would have the advantage of having better prepared and therefore more "inexpensive" partners, provided the candidates are admitted to the Union. Despite the steps taken in this direction through Agenda 2000, for example by strengthening Phare programs, it seems that the EU policies are inconsistent in their timing (*Inotai – Vida, 1998, p. 101*) and that serious incongruities exist relative to the cohesion countries.

STRATEGIC CONSIDERATIONS FOR AUSTRIA

The falling of the iron curtain presented Austria with the opportunity to again make full use of its geographic, cultural and economic surroundings, from which it was cut off for roughly 70 years. The focus of the European Union will shift to the east as a result of the enlargement, which will relieve Austria from its border status within the Union and the Union's domestic market.

Based on a sweeping evaluation, the disintegration of the Monarchy's integrated economic region has hampered Austria's growth, with one exemption: The forced orientation of Austria's economy toward the economic centres of western Europe had the advantage of providing innovative impulses that had not been sufficiently utilised in the context of the Monarchy's highly self-sufficient economic region.

Accordingly, both the eastern enlargement and the new orientation to the east will allow Austria to overcome a handicap. Due to these new opportunities, Austria has, for the most part, been supportive of the eastern enlargement process.

Most countries of the European Union regard the member countries with a border to those regions whose inclusion is being debated as the main long-term beneficiaries of enlargement. Included in this "enlargement coalition" are especially Germany and Austria, and to some extent the Scandinavian countries, Italy and possibly Greece. The other EU countries have the tendency to saddle any burden that may ensue on these "beneficiary" partners. On the opposite side of the spectrum, several "beneficiaries", in particular Germany and similarly – but to a lesser extent – Austria, have started wrangling with their role as net contributors to the Union. It would seem that their position as net contributors would lead to strong bargaining power. In the end, however, they will have to decide which goal ought to take precedent, decreasing their contributions or focusing on the strategic opportunities presented by an enlargement to the east (*Kreile, 1997, p. 206*).

To make this decision, it would be politically helpful if the economic opportunities associated with the enlargement for a country such as Austria could be positively identified. But two important factors stand in the way: the apprehension of the strains of net contributions and the more extensive need for structural adjustment, which seems to be particularly acute and intensive in the border regions.

For the entire EU domestic market as a whole, some of the concerns directed toward the border regions may seem of secondary importance. The same view could be applied to the immigration flows from the CEECs. However, the burden of adjustment generated in the immediate neighbouring countries and in the border regions cannot be overestimated, and of course, it also is relevant from a political point of view.

From Austria's perspective, the most important problematic aspects are the following:

1. the threat to the jobs of citizens stemming from an opening of the labour market, the free trade in services and the increase in the relocation of companies to the new member countries (which will also benefit from their membership by becoming more attractive to investors);
2. a possible threat to national security, if the Schengen border is moved to the east;
3. heightened competition for Austrian producers, to the extent that they would stop being protected, as they are now, by the Europe Agreements' stipulations. These stipulations of free trade agreements protect producers at least in serious cases (suspected dumping); they also protect producers in the agricultural sector, in the sense that this sector is excluded from current free-trade agreements.

4. Competition with Vienna's position as a regional metropolis will increase because the candidates' membership to the Union would elevate the status of Budapest and Prague. However, this new constellation should not be evaluated just in critical terms.
5. The last aspect is an increased strain on Austria's infrastructure due to traffic, to the extent that it would increase with the enlargement of the Union.

Amongst all problems, it seems that labour market prospects constitute the gravest of all, especially those in the area of the current eastern border. Labour market problems of similar proportions could arise in Germany and possibly in the north-eastern region of Italy, but not in the Scandinavian countries. They will occur primarily at the eastern border of Austria, for two reasons:

1. The opening of labour markets could increase to harmful levels the commuter traffic within the commuter distances to the border. This is all the more realistic, as there are centres of agglomeration in the area both within and outside the Austrian border, such as Vienna, Bratislava, Győr and Sopron.
2. Part of Austria's eastern region constitutes within the Austrian economy and the European domestic market a periphery, whose businesses could be swayed into maintaining their location mostly because of the relatively low level of wages prevalent in this region. An enlargement to the east would raise concerns as to the relocation of those factories and services, because the even lower wages across the border presumably provide the most important justification for the choice of location. This viewpoint should be argued and brought into the political arena during the reform process of the European Structural Fund, and measures addressing this problem should be pushed through.

A series of studies have made it possible to acquire an overview of labour market issues. The quantitative dimension of important aspects have not yet been tackled, in particular the consequences of both free trade in services and complete freedom of choosing a location in the border region, as well as the prospective trend to increasing relocations.

Three WIFO studies (*Walterskirchen – Dietz, 1998, Palme – Schremmer, 1998, Mayerhofer et al., 1998*) have provided significant points of reference (including a crude sector analysis), all of which can be compared to other studies focusing on this problem (see for example *DIW, 1997*). The results suggest that in the case of a total opening of labour markets, the strong incentives for daily and weekly commutes could, at first, overly strain the labour market of the eastern region, particularly if the Slovak Re-

public – and as such the area surrounding Bratislava – is accepted into the Union.

Since the devil is in the details, especially in this politically sensitive question, the Austrian position should be tightened by a more refined analysis. The focus of such an analysis should be the labour market for specific trades, occupations and qualifications, as well as the influence of migration costs including the cost of overcoming language barriers. Furthermore, another important question is whether the large wage gap between east and west, as it currently exists in Hungary and in the Slovak Republic, would significantly diminish the commuter and immigration flows, all of which have until now been estimated on the basis of country averages.

With some precaution, the problems of immigration could be more easily resolved than the commuting problems. In this context, the uncertainties associated with current forecasts raise again the question of what development would take place if the Union were not enlarged. If one is willing to assume that the economies of the prospective member countries will take a significant downturn as a result of disappointed expectations, it follows that the estimates of immigrant flows would have to be revised. This implies that employment opportunities would be eliminated for the domestic labour force as well, resulting in a less negative assessment of the net burden of enlargement imposed on the Austrian labour market.

Also, the question of whether it is really the current wage gap that determines the extent to which employees in the prospective member countries are willing to migrate should be examined. Or does migration depend rather on the expectations of rapid economic growth in Austria, which in turn would lead to higher wages there (*Von Hagen, 1996, p. 9*).

From a long-run point of view, the opening of labour markets appears to be more of a blurred issue compared to the current relatively high unemployment rates. For demographic reasons, the absolute size of the working-age population will start declining in the second decade of the next century, and this will lead to scarcity of labour in the labour markets. Under these circumstances, the opening of labour markets may constitute a most attractive way of alleviating capacity problems and of financing Austria's pension system.

With the eastern enlargement under way, the strategic position labour market issues take in the Austrian political arena has made clear that investment in education, in research and in various innovations has to become a high priority. Assuming that the CEECs will be marked by rapid economic growth and by unsaturated markets in many years to come, the eastern enlargement represents

an extraordinary stimulus to Austria's economic development.

The experience drawn from past steps toward integration should not be applied to the eastern enlargement scenario. In the long run, increases in exports similar to those prevailing at the beginning of the opening process are unlikely. Instead, we can expect import pressures to increase, not only from competing, but also from complementary products.

And yet, the inclusion of these neighbouring countries into the Union would present the Austrian economy with additional opportunities and with a diminished exposure to risk. Estimating the extent to which the Austrian economy would be stimulated is difficult. The stimulation effects stem not only from the expansion of foreign trade flows, but also from the possibility of increasing net value added. A common domestic market would decrease transaction costs. The net value added and the returns from deeper economic and political ties would increase Austria's income beyond what it would have been with the positive trade balance effects only.

At best, models primarily based on trade flows (and occasionally on direct investment flows) implicitly take into account the density and predictability of orderly conditions, as well as the role of information flows and informal contacts. This is because these factors allow for a better utilisation of co-operative projects, and because they increase the willingness to take on a higher level of risk in investment projects or other commitments.

Considering the historic opportunity for enlarging the Union to the east, some have pointed out that enlargement is a calculated step, especially for Austria. This is not an empty argument, for Austria can only benefit from its geographic closeness and cultural affinity to the prospective member countries. In combination with Austria's greater experience relative to those countries, these advan-

tages could be consolidated over time. Austria's eastern region, in particular Vienna, could then take on the role of a supra-regional focal point, as centre for high quality services and for the staff functions of multinational companies. The resulting increase in income would not be generated just by foreign trade. To reach this potential, or in reverse terms, not to waste this potential as a result of the short term problems should be the strategic goal of Austria's political system.

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The extent to which the economy will benefit from the EU's eastern enlargement will hinge primarily on political factors: the kind of institutional reform the EU will have undertaken up to that time, the balancing of conflicting interests between those who gain from the enlargement and those who lose, the adaptability of social structures in the countries aspiring to membership, and the intensification of contacts in the information society. Moreover, the question remains as to how the transition countries would develop if they were not allowed to join the Union

within a reasonable time period. As a close neighbour of these countries, Austria can expect to benefit from the increase in economic opportunities associated with the enlargement, but it must also face greater adjustment problems, especially in the border regions. Some of the most difficult problems to be expected during the transition period will be arising from the labour market. An increase in financial transfers to the prospective member countries could be at odds with Austria's desire to reduce its net payments to the EU.

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