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ENLARGEMENT
A PROCESS RATHER THAN A POINT IN TIME

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Introduction

The 1st of May 2004 is being marked by numerous important political events, speeches and festivities. This is appropriate in the sense that on that day ten new member states join the EU. However, "all" that happens on May 1st is that the EU's *acquis communautaire* becomes the law in the new member states. In order to make this happen, a decade of intense preparations on both sides was necessary and it will certainly take another decade before the full consequences of this enlargement will be felt. Enlargement should thus be viewed as a process, and not a single event taking place on one day.

For a think tank with the motto 'Thinking ahead for Europe', enlargement is old news. CEPS researchers have been analysing the many issues surrounding enlargement for at least the last dozen years, when it seemed only a distant dream. Over time the debate has shifted from the basic question of whether countries that had been forced to live under communism for so long would actually be able to qualify for EU membership to the basic policy issues: What will it cost? How will it affect our security? These are the basic issues surrounding any large political project.

The following pages provide a brief overview of the main findings of CEPS research on enlargement over the years. We start with an evaluation of the importance of enlargement in quantitative terms (GDP, population, etc.) and then turn to an evaluation of its broad economic impact, which is likely to be small for the old members, but large for the new members. This leads us to issue of the cost of enlargement (for the old EU-15), which is also rather small. The answer to the question 'what is in it for us', which is often posed in the old member countries, is thus perhaps disappointing: very little either way, in purely economic terms, there are small costs and small benefits, with probably as small net effect. Here the time dimension becomes important as the benefits will increase over time, faster than the potential costs through the EU budget.

We then turn to another issue that has received a lot of attention lately concerning the free movement of labour, drawing attention to the fact that large-scale migration is unlikely at any rate. Finally, we assess the widespread concern that an enlarged EU (of 25 or 27 members) will cause gridlock in the policy-making processes of the EU institutions.

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Is it such a big deal?

It is often argued that this coming enlargement is unprecedented in terms of the increase in population and other measures. This is not the case, however, if one considers the size of the countries that joined during previous enlargements, relative to the size of the EC they joined: this enlargement will lead to an increase in GDP of less than 5%, which is much less than the Iberian enlargement. Looking at the increase in trade flows, this enlargement is also marginal as the 10 CEECs (thus, including not only the 8 CEECs from the 2004 wave, but also Romania and Bulgaria) account only for 11% of the external trade of the incumbent EU-15. This is more than Spain and Portugal, but less than the increase during the first enlargement. Even in terms of the increase of the population, this enlargement is not much more important than the Iberian one. The population increases by 28% including all 10 CEECs; otherwise it would be only around 20%, close to the value of 17.5% for Spain and Portugal.

For those looking ahead to future enlargements, it is interesting to note that the accession of Turkey will be even less important in economic terms than this enlargement. Moreover, one rule of thumb might become very useful: Turkey equals 2-3 times Romania; it has a very similar GDP per capita, a comparable track record in terms of growth over the last years, a similar share of agriculture, and also problems with macroeconomic stabilisation.

Table 1. Size of this enlargement compared with previous ones (in percentages)

	Population	GDP in euro	Trade
UK+DK+IRL as % of EC-6	33.5	27.9	13.1
E+P as % of EC-10	17.5	8.3	4.7
CEEC-10 as % of EU-15	28.0	4.1	10.9
Turkey as % of EU-15	17.0	2.4	7.0
Turkey as % of EU-25	13.2	2.3	6.0

Source: Own calculations based on EU and EBRD data.

The main argument why this enlargement might be special thus boils down to two observations:

- The new members from Central and Eastern Europe are much poorer and more ‘different’ than previous member states.
- The number of member countries increases by 10 (and then in 2007, by another 2), creating problems for the EU institutions. This issue will be treated separately below.

The first observation is correct. The CEECs are still very poor, as evidenced by the fact that their GDP per capita, measured in purchasing power units, is on average less than one half that of the EU-15, but they are also much more dynamic. Health not wealth should be the decisive criterion when considering the impact of a new member on the EU. Viewed from this perspective, the outlook is promising. Growth rates are generally expected to remain around 4-5% in the CEECs for the foreseeable future, compared to about 2% for the EU. This still implies that full catch-up in terms of GDP per capita will take decades, rather than years, but full catch-up is not the relevant criterion if one is concerned about enlargement. Experience in the EU has shown that problems are much more likely to arise from established rich member countries with stagnant economies (Belgium in the 1980s and Germany today) than poor, but more dynamic states (e.g. Greece and Ireland today).

What is the economic impact of enlargement?

Table 1 above showed that the economy of the EU-15 is 20 times larger than that of the 10 (and even the 12) new members. This implies immediately that the impact on the economies of the EU-15 will be marginal, but the story is different for the new members.

Formally, enlargement means an extension of the internal market and, potentially, the euro area (all new member countries have signed up to the political aim of joining the euro as soon as possible). The benefits of these two integration projects for the present membership have been estimated and could be used as a guide. Recent estimates of the transactions cost savings from the introduction of the euro are in the neighbourhood of 1% of GDP (see also Chapter 7 in Gros and Thygesen, 1999). It is more difficult to estimate the gain from participation in the internal market. Emerson (1988) found that this should yield welfare benefits of between 2.5% and 4.5% of EU GDP. Could one use this estimate for the candidates as well? Several arguments would indicate that the benefits for the CEECs should be at the higher end of this range, or even higher. The key consideration is that all the CEECs are very small economies, which should thus benefit more from the additional competition fostered by the internal market than the larger and more diversified EU economies. Moreover, integration and market opening in the EU have proceeded well beyond the sectors considered in the initial ‘1992’ programme.

Even if one does not take into account these elements, any estimate of the welfare gains for the CEECs is bound to be higher than that for the EU-15 since intra-EU trade accounts for about 15% of EU GDP, whereas trade with the EU accounts on average for well over 20% of the GDP of the CEECs. The benefits for the new members should thus be at least one-third higher; 4.4-6% of GDP for participation in the internal market and 1.3% for using the common currency. The simple table below summarises these back-of-the-envelope calculations, which lead to the result that EU membership should yield a measurable benefit of between 5.4% and 7.3% of GDP for the CEECs.

Table 2. Measurable benefits to the CEEC-10 from EU membership (as % of GDP)

Common currency	1.0 – 1.3
Internal market	4.4 – 6.0
TOTAL	**5.4 – 7.3**

Source: Own calculations based on estimates for the EU-15 of the gains from a common currency and an internal market.

These measurable gains are already sizeable, but in reality the benefits for the CEECs will be much larger because enlargement has so many other implications. For example, EU membership transforms conditions under which the CEECs have access to the world capital market. Before accession became virtually certain, they had to pay hefty premiums in the international capital markets, an important consideration for countries that need to import large amounts of capital and that have accumulated significant sums of foreign liabilities.

How much will it cost?

This is one of the most often-debated issues, but it turns out to be relatively straightforward, and of little economic interest.

The cost to the EU can be easily calculated as it comes mainly under two headings: aid to poor regions under the Structural Funds and the cost to the Common Agricultural Policy.

Structural Funds. The Berlin Council decided, and this has subsequently been accepted by all participants, that the limit to the absorption capacity of Structural Funds should be 4% of GDP. Given that the GDP of the new members amounts to about 5% of the EU-15, this implies that the total cost of the SF for the new members should be around .2% of the GDP of the EU-15. This is just another consequence of the difference in economic size: only a small cut by the EU-15 is needed to make room for transfers to the new members, which would be very substantial for the new members.

CAP. A number of recent studies (and the proposals from the Commission) converge on figures of around €10-15 billion annually – less than the .2% of GDP for Structural Funds. (See Policy Brief by Johan Swinnen.)

The overall cost of this enlargement for the EU budget, and therefore for the EU-15, would thus be at most .4% of GDP (probably somewhat less counting also the contributions from the new members). This should be compared to public sector expenditure that are over 100 times larger (above 40% of GDP) in most member countries. It is thus clear that enlargement will not bankrupt any EU government. But why has the debate about the cost of enlargement been so fierce. The real question is not how much it will cost, but rather: Who wants to pay for enlargement?

The right answer to this question is easy: nobody. All EU politicians claim to be for enlargement, but they also say in unison that somebody else should pay for it: the current net beneficiaries argue that they cannot be asked to accept less because it would be unfair to finance enlargement by cutting transfers to the poor. The current net contributors argue that their populations will simply not accept any increase in their transfers to the EU budget.

In the final analysis, however, the correct answer to the question of how much will enlargement cost is simple: whatever member countries agree to pay, because all member countries have to agree on the budget.

What is in it for "us" – EU-15?

There can be no doubt that enlargement does not only lead to a cost for the EU's budget, but also to significant welfare gains for the incumbent EU members. These gains are real, but of course much smaller in terms of the EU-15 GDP than the gains for the new member countries whose economies are still relatively small. The key for any estimate of the welfare gains to the EU-15 is that expansion to the East increases trading opportunities for them as well. The new member countries account for less than 5% of the EU-15 GDP but about 10% of the EU-15's external trade. Enlargement thus enlarges the internal market (and after some time, also the common currency area) by about 10%. It has been estimated that the internal market among the current 15 EU members yields welfare gains of about 4-5% of GDP. This implies that the gains to present EU members from the inclusion of the 10 new members in the internal market should thus be about .4-.5% of GDP, or about €38-48 billion per annum.

The welfare gains from enlargement would thus be about twice as large as the budgetary cost, which is likely to be around .2-.25% of the GDP of the EU-15.

Moreover the gains for the current members can only grow over time as the economies of the new states grow along with their trade. Their share in the overall external trade of the EU has already doubled over the last decade and on current trends it could well double again by the end of this decade. At that point the estimated benefit would be twice as large as it appears from today's point of view. As the budgetary costs would not necessarily increase proportionally, it is clear that the economic benefits of enlargement to the present 15 members will even more clearly outweigh the costs than they already do today.

From the accounting perspective, the impact of enlargement on national budget deficits (not really its cost) would be measured by the increase in the contributions the incumbent EU-15 would have to make to the EU budget. This leads back to the issue of the overall size of the EU budget. If one takes the Commission's proposal as the point of departure, the EU budget would go from .98% to 1.15% of the EU's GDP. This would imply that for all EU-15 countries the national contribution would have to increase by about .17% of GDP. This might be compared to an overall structural deficit in France and Germany of around 3.5% of GDP in 2003. The additional 'accounting' burden from enlargement for the German (or French) budget is thus about one-twentieth (1/20) of the actual fiscal deficit. Assuming that the target fiscal position should be the 'close to balance' required in the Stability Pact, one could thus argue that enlargement would amount to about 1/20th of the required adjustment effort in Germany and France.

Towards a free movement of workers?

From 1 May 2004 onwards, the right of free movements will be applied to new member states' *persons*, but it will not automatically be granted to their *workers*. The latter can be denied one of the four freedoms of the Single Market if the old member states decide to apply so-called 'transitional periods'.

The vast majority of the present member states will do so with the beginning of enlargement, even those that announced an open-door policy earlier. Their recent moves seem to be driven by the fear that a major inflow of workers from the accession countries will flood their labour markets, either willing to work for little money or exploiting generous social benefits. There is no doubt that the free movement of people is a politically sensitive issue. Bearing in mind the wide range of implications this freedom entails – cultural, economic, social and legal in nature – a degree of uncertainty and hence unpredictability of the effects may indeed be undeniable. Yet the question remains whether the imposition of barriers for workers is valid.

The transitional arrangements, which were first agreed in the Treaty of Accession signed last summer in Athens, restrict access to EU-15 labour markets, often in the form of maintaining quotas for work permits. Hence, for a period of up to seven years, i.e. potentially until May 2011, workers from the 10 new member states will still be subject to national immigration laws as well as regulations governing the issue of work permits to non-EU nationals.

On the basis of estimated migratory flows and economic effects as well as recent survey findings, the case for transitional arrangements seems to be rather weak. Research on the effects of EU enlargement on workforce migration concludes, assuming free movement from 1 May 2004 onwards, that East-West flows are likely to be small and that they may in the long run even dwindle or possibly reverse. Nor do they imply major impacts on the current EU labour markets and social welfare systems.

Newly updated projections by the DIW (Deutsches Institut für Wirtschaftsforschung) on migratory patterns state, for example, that the potential inflow from the Central and Eastern European countries (CEECs) over the next 25 years will at most be 3.7 million persons in total. The inflow into the EU-15 on a yearly basis is estimated to be between 318,000 and 400,000 from the start of free movement – and thus the inflows per year will at most account for 1% of the current EU population. Two recent papers by Stephan Drinkwater (2003) and the European Foundation for the Improvement of Living and Working Conditions (2004) in

Dublin, use cross-national survey data, have confirmed the view that post-enlargement flows are unlikely to have a major impact. The report by the Dublin-based institute finds that 1% of the new member states' working-age population, i.e. approximately 200,000 people per year, can be expected to migrate from the accession countries over the next five years under the condition of free movement, most of whom will be young, educated to university level or still studying, and living as single persons without dependents. Apart from Germany, which presently attracts 60% of the inflows, Italy and Austria are expected to be the major countries of destination.

If one looks at the current state of migration between Germany and the acceding countries, the imposition of transitional arrangements seems even less relevant. Even with 'closed doors' towards workers from the new member states, the flows taking place between the two regions are quite substantial and in the range of what is projected for the first years after the free movement comes into effect. Often, however, these flows are not officially recorded, since they are of temporary nature due to the national schemes for work permits in place. While, for example, the official net inflow appears to be low with roughly 20,000 people p.a., the number of people actually on the move is much higher. Immigration and emigration figures add up to 200,000 each year and show that while many people are immigrating, they are not staying in Germany for a longer period of time. Rather, they move back or on to other destinations soon after they arrive. In 2002, for example, of the roughly 320,000 new work permits granted in Germany under the different temporary schemes in place, the most frequently issued permit was for seasonal workers.

What is likely to happen with the introduction of free movement of labour?

The answer is: Not much. There are no queues of workers eagerly waiting to work in Germany. Existing quotas in the temporary schemes are not fully used or non-existent, as in the case seasonal workers. Hence, the regulations now in place, which will apply as long as the transitional arrangements will last, are non-binding. What might come along with the introduction of free movement, however, is a re-labelling of informal and illegal flows of workers as registered flows. The newcomers will face easier access in administrative terms and a longer-term perspective regarding their stay, which in turn could imply more favourable prospects for their successful integration into EU-15 labour markets.

Regarding the fear of 'social-welfare tourism', the case is similarly weak. The UK and Ireland, being the last countries besides Sweden to announce that they will not impose barriers to workers from the accession countries, just declared that they will restrict access to non-contributory social-welfare payments to new entrants (e.g. rent supplements, job-seekers allowance), unless they can prove they have been working (and residing) in the country of destination for a certain period of time. Hence, the granting of social assistance that usually depends on passing a means test is now going to be coupled with the requirement of 'habitual residency'. With this move in means-tested social security, precisely that part of welfare policies is going to be changed, where newcomers would have had the possibility to shop. In the field of social benefits (such as unemployment benefits), where the granting of payments is conditional on contributions to social funds in the past, the eligibility for new entrants, as for nationals, is not granted anyway. However, as a recent ruling of the European Court of Justice showed (case C-138/02), the risk of becoming a destination for means-tested 'social-security shoppers' is already contained in existing EU regulations.

Can the EU institutions cope?

Accommodating 10 new member states means that the EU institutions have to deal with a greater number of members and increased heterogeneity. In fact, it appears that while heterogeneity already marks the present Union, it is the quantitative increase from 15 to 25 that really constitutes a step change.

The 2000 Treaty of Nice provided for the necessary formal arrangements to enable the EU to enlarge by setting the shares of the new member states in all EU institutions. Since the Copenhagen agreement of December 2002, the new member states have already started being involved in many decision-making procedures, albeit in an informal or observer capacity. The challenges in practice will only be faced in the months to come when the Nice Treaty will be applied until the new constitutional Treaty is approved. And this is where the real accommodation will have to take place.

How will the increased number of member states affect the EU's institutions?

European Parliament. While facing only a modest increase in size from 626 to 732 seats, the entrance of the member states will mean an increase of national party-delegations. But with the reduction of the number of seats of most present member states, a number of fringe delegations are unlikely to return. After the usual period of reshuffling of groups and positions in the autumn, Parliament can be expected to return to its normal routines with a limited number of party-groups dominating the process while at the same time a lot of the political action takes place through ad hoc coalitions.

European Commission. After an intermediary period of a College of 30, the new Commission entering office in November will count one Commissioner from each member state. While a College of 25 is not ideal, there is no reason to think it impossible to make it work. In a recent CEPS Policy Brief (Crum et al., 2004), we underlined the key importance of appointing a capable Commission President who not only understands the politics of the EU but has a superior grasp of the policy dossiers the Commission has before it. It will be up to the managerial skill of the Commission President to get the best out of the Commissioners by assigning them political tasks rather than administrative responsibilities and by recognising that there is no way round the principle of political collegiality.

Council. In the end, the working procedures of the Council are the most affected by the increase in member states. The traditional *tour de table* that allows each state to have its say becomes unbearable with 25 or 27. Quite likely a lot of deliberation that up till now could take place in the meetings will move into the corridors where different ad hoc coalitions may be formed to take the initiative on certain policy dossiers.

Whereas at present the Council mostly seeks to decide by consensus, with 25 majority voting is much more likely to be invoked. As has been shown in a series of CEPS Policy Briefs by Richard Baldwin and Mika Widgren (2003 & 2004), the definition of qualified majority agreed in Nice severely reduces the statistical likelihood that a decision can be passed in the Council. Even if in the present negotiations on the EU Constitution agreement can be found on a new definition of voting rules, this one is unlikely to enter into force before 2007. For the moment then, the EU legislative process risks getting bogged down in the Council.

Concluding Remarks

What can one conclude from this summary of recent CEPS research on enlargement? A first conclusion is that in strict economic terms, enlargement is a bargain in the sense that for the old EU-15 it probably represents a small benefit. The new member countries of course gain much more, but the size of their gains will in the long run depend on their capacity to improve their domestic institutions and hence their own growth prospects. The widespread fears that workers from the new member countries in Central and Eastern Europe will swamp EU-15 labour markets are unfounded. The transition periods that the old members have given themselves are thus only a useless populist gesture, but one probably that has little economic impact anyway. Finally, it is difficult to predict whether an enlarged EU can work with the present institutions. The one EU institution that seems most in need of reform in view of enlargement is the Council. One must thus hope that the draft Constitutional Treaty will be approved soon.

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