

Europe and the Concept of Enlargement

Paolo Cecchini, Erik Jones and Jochen Lorentzen

European enlargement is not a simple matter. Europe has no manifest destiny. Most Europeans do not even agree on what the boundaries of the continent are or whether they should be defined geographically, culturally, linguistically, or religiously. Enlargement also does not benefit from a clear popular mandate. Polling evidence suggests that only a minority of the West European public is behind an expansion of the Union. Nevertheless, European enlargement is a political obligation written into the treaty that founded the European Community in 1957. At that time, the founders of the Community called upon all states that shared in their ideals to join in the process of integration. Moreover, it was this idealism that led the Community to take in Greece, Spain and Portugal in the early 1980s.

The idealist logic of European enlargement has a deeply practical side to it. With Greece, Spain and Portugal, the principal objective was to shore up the democracies that emerged after the collapse of more authoritarian regimes. A similar objective lies behind the present enlargement. Specifically, the European Union's enlargement east and south is an attempt at risk management: the major economic transformations underway in Eastern and Southern Europe have unleashed forces that – while not unfamiliar in most advanced industrial societies – could well topple fledgling democracies. This challenge is different from that faced with Greece, Spain and Portugal, not only because the disparities in economic capacity between the candidate countries and existing member states are much greater, but also given the difficulty of stabilising political regimes through the process of developing market economies.

With practical objectives come practical considerations. Enlargement creates political risks for the EU even as it works to alleviate such risks elsewhere. It will upset old bargains at the heart of the EU's system of transfer payments, especially in agricultural subsidies and regional convergence. The EU will have

Paolo Cecchini is a former Commission official. **Erik Jones** is Jean Monnet Senior Lecturer in European Politics at the University of Nottingham. **Jochen Lorentzen** is Associate Professor of International Business at Copenhagen Business School. This argument was first developed as a series of joint presentations at North Carolina State University and at the European Union Center of the University of North Carolina at Chapel Hill.

to find new compromises, unpalatable to many, over an institutional set-up that would allow an enlarged Union to continue to function. Following the difficult budgetary negotiations in Berlin (March 1999) and the contentious institutional negotiations in Nice (December 2000), the challenges on both counts should not be underestimated. Finally, a more complex and more complicated Union could lead to a *de facto* reduction in cooperation among the member states and, ultimately, to a loss of purpose for the whole edifice of European integration. These risks are real, and they are serious.

Nevertheless, a failure to act would be even more perilous. The enlargement of the European Union is not the same as the economic integration of West and East. European enlargement is a structured, formal process. Integration takes place piecemeal through the activities of firms and individuals. Where enlargement brings rules and procedures, integration brings opportunities and risks. The increasing integration between East and West over the past decade has brought economic benefits to firms and consumers alike. East European firms are participating in EU-centred production hubs and have joined global corporate networks. Those countries currently striving to join the EU are among the more stable emerging markets, and foreign investors have used them successfully to increase global competitiveness in many sectors. Along the way, these investors have helped to advance industrial modernisation and technological upgrading in the transition economies. But, at the same time, the social toll has been disturbingly high. The European Bank for Reconstruction and Development (EBRD) estimates that the number of poor roughly quadrupled during the transition.¹ The problem is that economic reform and growth alone will not eradicate poverty; indeed, they may exacerbate it.

As unwelcome consequences of structural change, poverty and inequality exemplify the political risk of transition that the prospect of EU enlargement should mitigate. This attempt at mitigation will be successful only if political leaders on both sides of Europe show the political courage and wisdom to insist on EU enlargement as the most desirable formula for guiding integration towards prosperity and stability in Europe. Both the effectiveness and the legitimacy of the European Union are at stake.

In the West, European heads of state and government must press ahead with institutional reform that is essential for the success of enlargement. In addition, they must quickly improve the public perception of enlargement in West Europe. In the East, governments must not only adopt but must also apply the more than 80,000 pages of European Union legislation known as the *acquis communautaire*. Any attempts to bargain for opt-outs or to slow down the process of implementing these provisions will only encourage existing members of the Union to delay the date at which any treaty of accession can come into force. At the same time, however, many of the candidate countries have begun to attach too much political importance to fixing the date of accession as soon as possible. This tension between unnecessary delay and peremptory action is detrimental. As the European Commission representative to the negotiations has emphasised repeatedly, the quality of the negotiations is

more important than the date by which they are completed. By implication, West and East must be committed to solving any problems prior to accession, but without drawing out the process. And governments on both sides, but especially in the East, must find ways to reconcile the gains to society at large with the losses imposed on vulnerable groups.

The Nature of Political Risk in Eastern Europe

The transition from a planned to a market economy creates winners and losers. This is not surprising – in any society some groups find it easier than others to adjust to structural change. Some people have a strong enough motivation to try their luck even under difficult circumstances. Some have skills and qualifications that match new job profiles. Some can afford to live without employment long enough to seek training and so improve their job prospects. Some are willing and able to move or commute to emerging growth centres. What they have in common is the ability to exploit new economic opportunities. Czech and Slovak engineers in VW's assembly plants, Polish stockmarket whizzkids, Estonian software programmers under contract to multinational information-technology groups, and Hungarian mathematicians in research labs owned by Nokia and Ericsson, belong to the fortunate group of winners. Transition is nothing but structural change writ large: a wholesale overhaul of the basic understanding behind and the rules of economic organisation. But to some, it represents an insurmountable challenge because they lack the insights to understand the requirements of economic adjustment, or the means to invest in the improvement of their situation, or because they are too old (or much too young) to try. Miners in Romania, steelworkers in Slovakia, bank employees in Hungary and Slovenia, shipyard workers in Poland, civil servants and farmers in all of these countries belong to the unfortunate group of losers.

The risk is either that the winners will force adaptations that are unnecessary or detrimental to society as a whole, or that the losers will block adaptations that are necessary and beneficial. The implications of this risk are both economic and political. In economic terms, the threat is that such groups will distort the functioning of the marketplace by skewing the distribution of resources away from considerations of general efficiency and towards more explicitly self-interested criteria.² In political terms, the threat is that these groups will subvert the democratic process by imposing their wishes on the government, by ring-fencing parts of the policy process from outside interference and accountability, and by delegitimising open and transparent procedures for representation. On both fronts, therefore, the danger is that markets will become less liberal and governments less democratic – effectively reversing the economic and political reforms the candidate countries have been pursuing over the past decade.

Such political risk exists in all countries and across Europe, East and West. Romanian farmers and Polish trade unions are not more powerful than their counterparts in France and Italy. And engineering firms in the Czech Republic

or Hungary hold no more sway over their respective governments than, say, Germany's machine-tool manufacturers or the City of London hold over theirs. Indeed, economic change is all around us, and so is the political risk that comes with it. The difference between East and West lies in the capacity of governments to accommodate such risk. In the EU, governments can use redistributive measures to silence noisy losers. They can also rally other groups to support market efficiency and representative politics against the opposition of those who seek to use force to protect their gains or to recoup their losses. For example, consent to the completion of the European Union's internal market in the late 1980s and early 1990s was bought partly through cohesion funds and increased regional transfers. More importantly, its success depended on a broad coalition across societies in favour of further integration and liberalisation.

In the East, governments must make do with empty coffers. Buying the support of losers is therefore not a feasible option for risk management. At best, adequate welfare provision is planned for better times. At worst, social safety nets are simply absent. Thus governments may have to raise taxes and so force adjustments without being able to offer the transfers or public services that make such adjustments manageable or even possible.

The ability of governments to mobilise broad support in favour of economic reform is also more circumscribed in the East than in the West. Well established and broadly based political parties with wide-ranging – as opposed to narrow – economic interests and a firm stake in the functioning of representative democracy are rare. Instead, political parties often lack financial resources, loyal activists, and organisational experience. Their material commitment to the system of representative democracy is narrower and their need to engage in fierce competition for floating voters is greater. On the whole, this makes for a more fractious political process. Ten parties form the reform-minded and EU-friendly government coalition in Slovakia. Theirs is a complicated arrangement with four electoral parties – Democratic, Socialist, Social-Liberal, and Hungarian Minority – wielding power on behalf of the host of smaller political groups.³ Meanwhile, in the face of economic and social upheavals, former prime minister Vladimir Meciar – who stands for anything but market and democracy – remains the single most popular politician in the country. Should he succeed in a run for the presidency in 2002, Slovakia's quest for EU membership would be in serious trouble. More important, the country's future would lie in an authoritarian form of racket capitalism that benefits only an inner circle of cronies, and that would do much to undermine stability beyond its borders.

So the EU's desire to respond to political risk in the East is easy to understand. Its long-term interests are straightforward: an open business environment, partners capable of negotiating issues of common concern, and societies committed to integrative, as opposed to nationalist, problem solutions. In the absence of political risk, all of this would be possible without enlargement. With political risk, nothing is. Thus for the EU accession is an

exercise in risk management in which it underwrites economic and political reform in its neighbourhood of countries through the invitation to join the club. For the candidate countries, the prospect of EU membership provides a focus for political activity in support of market efficiency and political openness. It represents the stake that mainstream political parties in the candidate countries have in supporting 'the system' against those challengers that mobilise along single-issue campaigns. The prospect of membership can serve as a lowest common denominator for diverse coalitions of interest that separately support only part of the liberalisation and democratisation agendas. The prospect of membership also symbolises the benefits available to individuals and to firms in exchange for accepting the hardship of adjustment.⁴ And because the rules of accession include respect for human rights, this will help to reduce discrimination against minority groups such as Russians in the Baltic states, Roma in the Czech Republic, and Hungarians in Slovakia or Romania. Such provisions will also support an improvement in the terrible condition of the 100,000 children in Romania's child-care institutions. Thus, adaptation to EU membership is more likely to be beneficial to all of society than a general – and inevitable – adaptation to world markets alone.

This strategy is no free lunch for Western Europe. The downside is potentially enormous both for individual West European countries and for the Union as a whole. EU enlargement will necessarily force countries to forego cosy distributive arrangements for agriculture, fisheries and regional development. A continuation of existing subsidies beyond enlargement would be prohibitively expensive. According to the European Commission's *Eurobarometer* survey, just three people out of ten believe that enlargement should be an EU priority.⁵ Given the choice, the West European public would rather devote resources to fighting unemployment (90%), crime (88%), and poverty (87%), to maintaining peace (88%) and democratic freedoms (80%), and to protecting the environment (84%) and consumers (79%). This is why calls for new Marshall Plans to bankroll the transition in the East are mainly backed by idealists or academics who are out of touch with the real world. The cost to Europe as a whole centres on the effectiveness of the European Union as a political system. Before the treaty revisions agreed at Nice in December 2000, the institutional set-up of the EU could be more or less maintained only in the absence of enlargement. A prime motivation for making changes to those institutions relating to representation in the European Commission and voting in the European Council was to adapt the framework for decision-making to accommodate some 13 new members. Such accommodation required that EU governments strike compromises on majority voting, flexible participation, and national representation that are hard to swallow and, therefore, difficult to negotiate. As a consequence, observers immediately began scrutinising the results of the Nice revisions to see whether the progress was sufficient for enlargement to continue.

Such institutional scrutiny is necessary but risks missing the larger problem. Even a reformed institutional arrangement does not guarantee the success of

the EU.⁶ The most contentious moments of European integration occurred not because Europe's institutions failed to function adequately, but when French farmers, British beef producers, Spanish fishermen, or German regional banks succeeded in lobbying their national governments for policies that went against the grain of economic integration. The vulnerability of the EU to such concerns is also evident in the fact that seemingly irrelevant issues such as the consumption of snuff in Sweden, the alcohol content of *Cassis de Dijon*, the purchase of Danish holiday homes, and the comparison between Belgian and British chocolate can be elevated to continental significance. The EU's already manifest weakness when confronted with well-organised special interest groups means that it ultimately depends on the goodwill of its member states. When the countries that comprise the Union are willing and able to cooperate, the institutions of Europe can work effectively no matter how they are formally constituted. When the member states are unwilling or unable to work together, the effectiveness of the Union suffers. This simple relationship was as apparent when the EC consisted of only six member states as it is today and as it will be once enlargement takes place.

What will change with enlargement is the likelihood that disenchanted losers or unreasonable winners from transition will hold Europe's member states hostage to their particular interests. If enlargement brings in a host of new members before these countries have completed the processes of political and economic reform, the effectiveness of the EU as a whole will suffer. And since superior effectiveness provides much of the legitimacy for European integration, this could translate into an outright loss of purpose. Europe needs only look to its own past to recognise the danger. After the first enlargement of the European Community to bring in the United Kingdom, Ireland and Denmark, the institutions of Europe entered into a long period of sclerosis. In part, this bout of pessimism was due to the economic shocks of the 1970s. To a large extent, however, it was due to the vacillation and intransigence of the new British member with respect to its financial obligations to the Community. Without going into matters of equity, suffice it to say that both problems highlight the political risk inherent in enlargement – and that in a context of relatively equal partnership.

The overwhelming lesson to draw from Europe's first enlargement is that premature accession is bad for all parties. It can cause unnecessary political turmoil in the candidate countries and it could ruin the EU as we know it. Moreover, target dates by themselves make no sense. If preparations for accession in a candidate country slow down because of a government crisis, insisting on some arbitrary date for entry would do nobody a favour. By the same token, a lackadaisical approach to economic and institutional reform in the EU is lousy politics. EU leaders have a natural inclination for navel-gazing, and they prefer to negotiate administrative details rather than debate grand political schemes. This is bad. It neglects the fact that the prospect of EU membership is crucial to the success of the transition in Eastern Europe, and that Europe as a whole will suffer from an unsuccessful transition. A vision for

the future of a larger but still effective Europe must animate ongoing institutional reform and the accession process. At a minimum, whatever country holds the rotating EU presidency should facilitate the search for this vision. Despite great hopes at the outset and strong words at the end, the autumn 2000 French presidency failed to live up to this challenge. The European Council may have agreed to give a new impetus to enlargement in December 2000, but it has yet to provide a compelling vision for solidarity encompassing the whole of Europe. It is to be hoped that the Swedish presidency of spring 2001 will be more successful.

East–West Business Integration

Without economic integration, enlargement makes no sense. The reverse, however, is not also true. Economic integration will happen with or without enlargement. Since the opening of the East European economies a decade ago, East and West have integrated more and faster than seemed possible only a few years ago. And firms on both sides have found ways to work together even when the trade provisions of the Association Agreements restricted their commercial ambitions. The change in the geographic composition of Eastern Europe's trade towards the EU was so fast and sizeable that the EU and the candidate countries now have a similar regional trade structure. The share of Estonia's exports going to the EU is as high as Greece's, and the Czech Republic and Hungary source as great a share of their imports from the EU as does France. An increasing part of this trade is intra-industry, which demonstrates the growing complexity and maturity of economic integration between the EU and the transition countries.

In fact, Western firms have been busy setting up cross-border networks. Since the mid-1990s, trade with and inward direct investment to Eastern Europe have grown faster than to any other part of the world. In 1999, mergers and acquisitions involving international groups in the East totalled \$17bn, almost twice the figure of 1998. The share of foreign capital in total investments in the region is higher than it is for developing countries or for the world as a whole. Research by the World Bank shows that the EU lies at the centre of a complicated web of manufacturing, with candidate countries involved in the production of office equipment, automotive supplies, telecommunications and more traditional sectors such as furniture, textiles and footwear. Research sponsored by the European Commission demonstrates that foreign-owned firms in Eastern Europe are more efficient and profitable than local firms; they also export more. As a result, the Czech Republic, Hungary, Poland, Slovakia and Slovenia now have an internationally competitive automotive supply industry, and Hungary and Estonia an emerging information technology industry. EBRD data show that the exports of these countries to the OECD are increasingly skill-intensive, meaning that at least some local firms have made good use of foreign know-how.⁷

The European Round Table of Industrialists which includes 48 of Europe's best-known multinational firms, is strongly in favour of enlargement. In the

long run, it argues, economic opportunities must be accompanied by a common set of rules and regulations to guarantee a level playing field for foreign and domestic firms.⁸ And an efficient administration would facilitate long-term investments. Clearly, the more serious the EU is about enlargement, the more incentives East European authorities would have to strengthen their institutional framework.

So far, the activities of countless small and large firms, and not some grand political scheme, have brought the economies of East and West closer. But while businesses can do the necessary footwork, they cannot bring the process of integration to completion. Only political authorities can do that. Without enlargement, economic integration is fraught with risk.

The Social Costs of Adjustment

Since 1989, almost everywhere in Eastern Europe, the number of people who live below a poverty threshold of \$4 a day (purchasing-power adjusted) has gone up. By the latest count, this affects some 25 million people. 20% of the population has experienced significant drops in income. Households with many children, single-parent households, and social-welfare recipients are the primary victims. In part, their predicament is due to a decline of average real incomes resulting from the double-digit recessions that accompanied transition in its earlier phase. More dramatically, a rise in income inequality is responsible for making parts of the population relatively worse off in material terms and absolutely worse off in terms of access to opportunities, whether social, economic, or political. The result is a burgeoning underclass. In Romania, measures of earnings inequality almost tripled in the 1990s, and even in more organised societies like Poland or Slovenia rose by around 40%.⁹

Of course, causes for the persistence of misery are often internal. When cronies are allowed to strip assets and transfer the proceeds abroad as under former Prime Minister Meciar in Slovakia, national income is reduced. When privatisation agencies sell housing stock not to tenants but to outsiders, they affect not just current but also future wealth distribution. By skewing the initial distribution of real property, they make it more difficult for individuals to borrow against their assets in order to invest in their own job-related skills or to afford decent schools for their children. When governments, as in Poland, are slow in removing regulatory and bureaucratic obstacles to the creation of new firms, they make it more difficult for employees of bankrupt state enterprises to move into the private sector. Indeed, any deficit in the provision of high-quality governance, including social safety nets, is inimical to poverty reduction. Fortunately, international organisations such as the EBRD have begun to pay more attention to the institutional framework necessary for successful economic reform. Even where governance is less of a problem, the social and economic costs of transition are high because building a new economic system is extremely difficult. Technological and organisational changes affect what kind of skills are in demand. Taken together with the available supply of appropriately skilled labour, technology and organisation

also influence the distribution of wages across skill groups. This influence is largely beyond any government's control. Therefore, unless educational systems can be made to provide the skills and qualifications demanded by the new economy, wage differentials are bound to increase, raising the overall level of inequality along with them.

There is no magic formula for good governance. What is clear, however, is that good governance starts with good rules. Inequality will not go away as the transition countries mature. What will go away, with time, are the differences in average per capita income between East and West, much as they have fallen between Ireland and the EU's southern periphery on the one hand and its northern members on the other, or between China and the rest of the world. But inter-country comparisons are statistical abstractions that say nothing about how well, or badly, people are doing. Poor people are more sensitive to shifts in relative international prices. When economies liberalise, they are doubly affected. This is what is behind the recent increase in global inequality and – despite structural and cohesion funds – inequality in Europe, East and West. In other words, income, resources, and wealth tend to concentrate among a limited number of people, firms, and regions.

The simple lesson here is that the process of economic integration is no substitute for the development of good rules for the management of labour, product and consumer markets. When Western firms invest in Eastern Europe, they ultimately promote growth and the ability to catch up. They also, seemingly paradoxically, exacerbate differences between dynamic and declining regions, between people with the right and those with the wrong skills, between places with good infrastructure and lucky geography and those with hardly any means to communicate and stuck in the middle of nowhere. It would be wrong to blame Western investors for this. More balanced regional growth and a convergence of income levels are not within the remit of firms. Political authorities must take care of such political-economy concerns because, unless addressed, they translate into political risk. Inequality is a fact of life, and EU membership will not eradicate it in the candidate countries. But the process of enlargement can provide a framework for developing rules that can help reduce unnecessary inequality. And it will make dealing with the challenges posed by economic integration more manageable.

Indeed the policy transfer at the heart of the enlargement process may (and should) work both ways. It is often overlooked that in some areas of social policy, the EU may be able to learn from some of the achievements of the candidate countries. Income inequality in the Czech Republic, Slovakia, and Slovenia is *below* the EU average.¹⁰ And despite their significantly lower per-capita incomes, the child mortality rates in the candidate countries – with the exception of Bulgaria, Latvia and Romania – are not that much out of line with those prevailing in EU countries. Indeed, in Slovenia child mortality is lower than in the UK or Belgium, for example. And 14-year old Czechs famously beat all their EU peers in the Third International Maths and Science Study, while Hungarian and Bulgarian students were better than students from most EU

member states. European enlargement is a formula for sharing the risks of transition. It is also a mechanism for sharing the benefits.

Conclusion

The European Union's drive for enlargement is neither impossible nor inevitable. It is complicated, difficult and fraught with risk both for the candidate countries and for the Union as a whole. Nevertheless, it is a necessary response to the consequences of the rapid market integration that has taken place since the fall of the Berlin Wall. On balance, the political risks and social costs of market integration without European enlargement are far greater than the challenges presented by an expansion of the European Union. Both Western and Eastern Europe stand to gain from a successful completion of the process. What remains to be seen is whether leaders on both sides of the continent can articulate a vision of Europe's future that can convince their electorates to support a process that should neither be too fast nor too slow, where complex negotiations defy simplification, and where even the best of intentions can offer few shortcuts. Europe's heads of state and government need to justify the concept of enlargement. Along the way, they also need to examine the concept of Europe itself.

Acknowledgements

The authors would like to thank David Calleo, Robert Elgie, Kathleen McNamara and Peter Møllgaard.

Notes

- ¹ *Transition Report 1999* (London: European Bank for Reconstruction and Development, 1999).
- ² See Joel Hellman, *et al.*, 'Measuring Governance and State Capture: The Role of Bureaucrats and Firms in Shaping the Business Environment', *Working Paper No. 51* (London: European Bank for Reconstruction and Development, June 2000); and Joel Hellman and Mark Schankerman, 'Intervention, Corruption, and Capture: The Nexus between Enterprises and the State', *Working Paper No. 58* (London: European Bank for Reconstruction and Development, October 2000).
- ³ The electoral parties are coalitions formed in order to comply with the relatively high minimum threshold requirements for parliamentary representation legislated by the (outgoing) Meciar government just prior to elections. See John Fitzmaurice, 'The Slovak Elections of 25th and 26th September 1998', *Electoral Studies* 18 (1999) pp. 290–296.
- ⁴ This argument is suggested (and yet not fully developed) in Jacques Rupnik, 'Eastern Europe: The International Context,' *Journal of Democracy* 11:2 (April 2000) pp. 123–124. The same argument is also used to explain the difference in the transition success and failure in the transition process. See Stanley Fischer and Ratna Sahay, 'The Transition Economies after Ten Years', *IMF Working Paper* (Washington DC: IMF, WP/00/30, February 2000) p. 22.
- ⁵ These data are based on fieldwork done in April–May 2000 and can be found in *Eurobarometer, Report Number 53* (Brussels: Commission of the European Communities, October 2000).
- ⁶ For a general form of this argument, see John Peterson and Erik Jones, 'Decision Making in an Enlarging European Union,' in James Sperling (ed.), *Europe in Change: Two Tiers or Two Speeds?* (Manchester: Manchester University Press, 1999), pp. 25–45.
- ⁷ Bartłomiej Kaminski and Francis Ng, *Trade and Production Fragmentation: Central European Economies in EU Networks of Production and Marketing*, unpublished manuscript (Washington DC: DECRG-Trade, World Bank, 1999); Jochen Lorentzen (ed.), *Foreign Direct Investment and Industrial Modernization in Central Europe*, a special issue of the *Journal of International Relations and Development* vol. 1 nos.1–2 (published jointly, 1998); *Transition Report 1999* (London: European Bank for Reconstruction and Development, 1999).
- ⁸ *The East-West Win-Win Business Experience* (Brussels: European Roundtable of Industrialists, 1998).
- ⁹ *Transition Report 1999* (London: European Bank for Reconstruction and Development, 1999).
- ¹⁰ John Micklewright and Kitty Stewart, 'Child Well-Being in the EU – and Enlargement in the East', *Innocenti Working Papers, Economic and Social Policy Series No. 75* (Florence: UNICEF Innocenti Research Centre, 2000).

