Can Eastern Europe Catch Up Without Structural Funds?

As things look today, the countries of Central and Eastern Europe will, except for Bulgaria and Romania, all have joined the European Union in another two years' time. The forthcoming accession round will be the most far-reaching in the EU's history. Never before have so many countries joined at the same time and never before has there been so wide a gap between the established and the new member states in their economic development levels. Both because the accession countries lag so far behind in terms of per capita incomes and because the role of agriculture is still significant in their economies, there would need to be a considerable flow of support from the Structural Funds and the Common Agricultural Policy into Eastern Europe if the new entrants were treated by the same standards as existing member states. The way things are going, the benefits the accession countries obtain from EU financial aid are likely to be pretty meagre at least until 2006. Aid from the Structural Funds will not flow to the new members until they have established the administrative structures the EU requires. A thorough restructuring of the flow of EU funds would not be conceivable until the 2007-2013 budgetary planning period. Yet even then, it is highly doubtful whether financial aid within the Union would be substantially focused on the new members, as the countries that have benefited most up to now have already signalled their intention to defend their entitlements even after 2006.

These limited prospects of receiving substantial financial aid from the EU are a great disappointment for the accession countries, whose hopes of receiving substantial transfer payments had been a substantial motive for seeking EU membership. It is difficult to convey to the people in these countries that the flow of funds will be much smaller than anticipated. However, quite another issue is whether there is not a tendency to vastly overestimate the part EU financial assistance will play in Eastern Europe's endeavours to close the economic development gap. The candidate countries have often claimed that they will never be able to catch up without this monetary aid.

In fact, having come through the transition crisis of the mid-1990s, the Central and Eastern European countries have already done a substantial amount of catching up. These countries' foreign trade now focuses strongly on Western Europe, and most of them have developed into attractive locations for foreign investment. Except for short periods in particular countries, economic growth in Eastern Europe over the past eight years has been higher than in the European Union. Thus the gap in per capita incomes between Western and Eastern Europe has narrowed, though admittedly it is still very large. With the exception of Poland, the Central and Eastern European economies have remained more buoyant – some of them much more so – during the EU's current recessionary phase, and forecasts for the years ahead are better for Eastern Europe than they are for EU member states. In other words, the catching-up process is already taking place, and so far it has operated without the candidate countries having received any appreciable transfer payments from the EU's coffers. The dynamism has been driven by reforms designed to encourage efficient markets in these countries and to step up their integration into the international division of labour, on a world and more especially on a European scale.

What will happen after the EU's eastward enlargement? Will the accession countries be able to continue closing the economic development gap, or will the process run out of steam without substantial help from the Structural Funds? In terms of their economic fundamentals, the new members will retain a good chance of continuing to close the gap. Their labour endowments and labour costs give them a clear advantage. As studies for Western European economies have shown, advantages in factor endowments have a significant influence on cross-border investment decisions, to a degree that can more than compensate for a peripheral geographical location. Indeed, the speed with which the economies of the cohesion countries Ireland, Spain and Portugal made up ground after their entry into the European Community bears this out. Moreover, in contrast to the cohesion countries a number of the candidates for accession also benefit from a relatively central location within an enlarged European economic area (this holds for the Czech Republic, Slovenia and parts of Hungary, Poland and Slovakia).

However, it would be fatally wrong to imagine that the catching-up process will continue virtually automatically for the Central and Eastern European countries once they have joined the EU. In reality, quite the reverse is true. The accession of any new member to an integration area inevitably heats up the competition among locations, and the increased rivalry affects the accession countries just the same. Thus the potential opportunities to catch up increase, but so too do the risks of staying behind. In other words, a country's policies as regards its attractiveness as a business location assume a greater responsibility for its economy's overall ability to close the development gap. Every (accession) country has to look after macroeconomic stability, to stick consistently to and uphold market-oriented reforms. Only then will it attract inward investment and be in a position to utilise its domestic resources efficiently. A number of Central and Eastern European countries have found out the hard way in recent years that policies detrimental to these requirements will cause a setback in closing the development gap, namely Bulgaria (1996-1997), Romania (1996-1999) and the Czech Republic (1997-1999). Greece offers a telling example showing that EU entry does not guarantee that the economy will catch up. After entering the EC in 1981, the country pursued rather unconvincing macroeconomic policies for a considerable period, its structural policies were geared to conserving existing industries, and it failed to modernise its administrative systems. Thus even though it received substantial sums from the Structural Funds – on a scale no less than Portugal, Spain or Ireland – its income per head fell back relative to the EU average. Not until Greece had made good some of its self-inflicted deficiencies in the early 1990s did it, too, begin to gain ground relative to the EU average per capita income. Any countries pursuing poor locational policies after accession would be destined to have similar experiences. They would deter investment, their growth would slacken, and that development gap would stop closing. Access to the EU's Structural Funds, on however large a scale, would do little or nothing to change this situation.

Eastern Germany offers a good example of how little impact transfer payments can have if market-operated forcers are insufficient to support growth. There has probably never been a region, in the recent past or at any other time, which has received so much support from others; in this case the bulk came from western Germany and some also from the EU Structural Funds. In the first half of the 1990s, eastern Germany's economy was growing with some dynamism, yet since 1997, it has been falling back relative to the western part of the country even though the volume of transfer payments is undiminished. The region's growth is now among the weakest in the entire European Union. Evidently, the transfer payments have not managed to bring about any lasting, thoroughgoing improvement in supply-side conditions in eastern Germany. In particular, development there has been very disappointing compared with the progress that Central and Eastern European countries have made largely without outside help.

Of course the accession countries are fully entitled to receive equal treatment from the various financial support programmes managed by the EU, and nothing written here should cast doubt on that. However, they need to judge realistically the contribution such assistance is likely to make towards their economic development. In the light of this assessment, it would be advisable for the EU's financial assistance to be cut back in general, and for these constraints to apply equally to existing and new member states.

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