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Eastward Enlargement – Benefits and Costs of EU Entry for the Transition Countries

The Central and East European transition countries are pinning considerable hopes for their economic future on entry into the European Union. However, given the huge amount of catching up they still have to do in economic terms, the tough entry conditions they have to meet and the limited amount of help the Union is willing to provide, it is questionable whether the benefits these countries will derive from entering the EU outweigh the corresponding substantial costs.

There now appears to be no stopping the EU's eastward enlargement to include the Central and East European reforming countries. Their governments are all taking the position that this offers the best way of stabilizing the democratic system in their particular countries,[1] and are overfond of using metaphors portraying Europe as "one single cultural region" or "sphere of civilization", while simultaneously warning of the "demons" of totalitarianism that are liable to be revived if the transition project is not backed up by clear options and time schedules for these countries' entry into the EU and NATO.[2] Yet despite that, European integration is no more than a marginal issue in the political debate within the transition countries. A great many in the general public have no concept of what EU integration actually means for their own country. So the danger is that the political élites will arouse unrealistic expectations which the EU is neither able nor willing to fulfil. That in turn could trigger off some substantial destabilizing effects in the transition countries' societies in the future.

For the economies still in transition, the EU offers a contrasting model of success which, by definition, meets the stability expectations of the Eastern European political élites. At its Copenhagen Summit on 21st/22nd June 1993, the EU Council drew up clear entry criteria for those countries wishing to join the Union: "The applicant country must have achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities; it must have a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the EU; it must have the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union."[3]

The entry candidates are more inclined to point out the cultural and political aspects of enlargement, whereas the existing EU is evidently not prepared in any respect to soften up its existing political and economic standards. Yet in purely economic terms, the difference between the "East and West" is huge, and it cannot but have a substantial bearing on the feasibility of any enlargement of the Union.

In the western half of Europe, we have the world's most populous common trading zone, with 360.8 million inhabitants and an average per capita GDP of US$ 21,000, while the economies of Eastern Europe are substantially less robust. Of course, substantial differentials still exist within the EU, or between the EU on the one hand and the USA or Japan on the other, but a glance at the GDP indices (in value and volume terms) shows that the transition countries are not just worse off by a matter of degree, but constitute a distinct class by themselves.

The average volume index attained by the transition economies listed in Table 1 is 25, or one quarter of the average purchasing power of the Western nations (that of Austria) used as a basis. Indeed, even the very top countries among the transition states still have only half that average output (the Czech Republic with 44 and Slovenia with 48), which still is not enough to match the last two member countries in the EU rankings (Portugal with 61, and Greece with 56).

Access to the Single Market could present the

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[1] Roxana Iorga: The EU and the Stabilization of the CEEC: Evolving Political Relations and Economic Agreements, in: Gianni Bonvicini, Maurizio Cremasco, Reinhardt Rummel, Peter Schmidt (eds.): A Renewed Partnership for Europe. Tackling European Security Challenges by EU-NATO Interaction, Baden-Baden 1995/96, p. 252.

[2] Vaclav Havel: Wir haben gemeinsame Werte. Die Union muß mehr sein als ein System zur Verteilung der Brüsseler Subventionen, in: ZEITpunkte, No. 4, 1996 – Wie geht's, Europa? Euro und Erweiterung machen zu schaffen, pp. 17–18.

[3] EU-Informationen, No. 1, 1995, p. 6.

opportunity to embark on a golden economic future for these countries, as the various freedoms covering trade in goods and services, the movement of capital and the establishment of new businesses will open up a host of new possibilities for economic activity.

However, the other side of the coin is that entry into the EU entails the adoption of all existing legal regulations, commonly referred to as the *"acquis communautaire"*. That will mean that the new entrants have directly and immediately to apply EU law, which not only includes the rules of the Single Market but also substantial aspects of competition policy, environmental and transport policies, the system of agricultural pricing, the rules of the customs union, relations with third countries, regional and structural policy, taxation policy (or tax harmonization by means of domestic legislation), fiscal competition, and the common currency. These aspects bring the well-known advantages of integration; nevertheless, they also entail a major burden upon the transition countries, as they are called upon to harmonize legal regulations and market conditions, and hence to abandon some of the present circumstances that are advantageous to them.

Table 1
Per Capita GDP Indices for 1993 (Austria = 100)

	Index in value terms	Index in volume terms
Austria	100	100
Belgium	92	103
Denmark	114	101
Finland	73	81
France	96	98
Germany	103	97
Greece	38	56
Irish Republic	58	73
Italy	75	92
Luxembourg	138	143
Netherlands	89	93
Portugal	38	61
Spain	54	69
Sweden	93	88
United Kingdom	71	89
Japan	148	106
USA	107	127
Poland	10	24
Czech Republic	13	44
Hungary	16	31
Slovenia	28	48
Estonia	5	20
Slovakia	9	30
Bulgaria	6	22
Romania	5	19
Latvia	4	16
Lithuania	3	19
Croatia	11	20
Russia	6	26
Belarus	2	26
Ukraine	3	17

Source: Eurostat 1996.

That raises the question as to whether, from the entry candidates' point of view, the benefits they can attain will exceed the costs incurred, and what advantages the fact of being a new member of an enlarged EU could bring to them. In this respect, a fundamental source of problems is the existing EU's attitude, since it tends to adopt a hierarchical approach towards the transition countries rather than to treat them as equals. The economic relations between Western and Eastern Europe since 1990 have been conducted on the EU's terms. So far, the EU has made use of two main instruments: firstly, the TACIS and PHARE assistance programmes, which should be regarded as short-term instruments, and secondly the various formal agreements reached with the transition countries, which are geared towards establishing long-term trading régimes with the signatory countries.

Association Agreements

The EU's cooperative relations with third countries by way of Association (or "European") Agreements are built upon older bilateral agreements with the Eastern European countries, dating back to 1988–1991.[4] The Czech Republic, Slovenia, Hungary and Poland have been linked to the EU by such agreements since 1991, Romania and Bulgaria since 1993, and finally Estonia, Latvia, Lithuania and Slovakia since 1995. The agreements cover the implementation of free trade within ten years, though with substantial, contractually determined restrictions in so-called "sensitive areas",[5] markets being reciprocally opened on an asymmetrical basis; the scope of the agreements is to be gradually broadened to cover the movement of capital and services, and cooperation will be promoted in the general political, economic, scientific, environmental and cultural spheres.[6] The EU has made sure that it protects itself against undue competitive pressure from exports originating in Eastern Europe by inserting a general "safeguard

[4] The agreements essentially cover market liberalization and the political prerequisites for such liberalization. As such, they follow the "standard procedure" adopted when taking up relations with third countries. No account was thus taken of the specific circumstances applying and the tumultuous changes occurring in the transition countries. On the politico-symbolic significance of the Agreements, see: Sabine Schirmer: Ziele und Probleme eines Assoziierungsvertrages Polens mit der EG. Ein Kosten-Nutzen-Vergleich aus polnischer Sicht, Hamburg 1991.

[5] The areas thus classified are the EU's relatively uncompetitive textiles, coal, steel and agricultural sectors.

[6] Roxana Iorga, op. cit., pp. 248 ff.

clause" into these agreements. The clause permits the EU to stray from its path of trade liberalization if domestic suppliers - an entire member state or an entire industry - appear in danger of no longer being able to withstand import pressure.[7]

Applications to join the EU have now been lodged by Bulgaria (16th Dec. 1996), the Czech Republic (23rd Jan. 1996), Estonia (28th Nov. 1995), Hungary (1st Apr. 1994), Latvia (27th Oct. 1995), Lithuania (8th Dec. 1995), Poland (8th April 1994), Romania (22nd Jun. 1995), Slovakia (27th Jun. 1995) and Slovenia (19th Jun. 1996). Again and again, applicant countries' governments publicly emphasize that EU membership is the golden road towards sustained stability in the democratic, market-economy structures currently still in the course of development.

Both sides avoid being too committal about the "when and wherefore" of entry. Even after the completion of the Inter-Governmental Conference at the Amsterdam Summit, the EU had not laid down any firm time schedule for the entry negotiations that were to commence in 1998. How many countries were to be involved in these negotiations, and which ones, with what final aim, were all matters that still had not been settled. On the one hand, a "starting-line model" had been put forward which envisaged entering into negotiations with all entry candidates, i.e. including Cyprus and Turkey alongside the Eastern European transition countries. On the other, the Agenda 2000 developed by the Commission included criteria which envisaged embarking on entry negotiations with a more select circle of candidate countries in the first instance. In addition to Cyprus, the countries cited as being in a position to fulfil the requirements for EU membership in the medium term were Hungary, Poland, Estonia, the Czech Republic and Slovenia. Finally, the Luxembourg Summit (12th/13th Dec. 1997) decided to start entry negotiations with these countries in April 1998. However, stress is being laid on the fact that the simultaneous commencement of negotiations does not imply that the negotiations with different countries will be completed at the same time, and that the pace of the admission process will depend on the performance of the countries concerned in the meantime.[8]

What the European Agreements have to offer the transition countries is not so much support for their economies in the form of genuine trade concessions as the hope that they will soon belong to the EU and be able to participate in the Union's resources.[9] These Agreements effectively function as an instrument for the EU to dictate its institutional and economic-policy conditions to the transition countries without any need to incur any substantial financial expenditure. The Agreements contain minimal concessions on the EU's part, which are intended to ensure that the Western countries are able to sell expensive capital and consumer goods in the East. On the other side of the coin, the flow of East-West trade in fields in which the transition countries are particularly competitive is either subject to quotas or even has the safeguard clause slapped upon it.[10] Against this background it is not surprising that the transition countries' balances of trade with the West European countries have been in deficit for years.

The Agreements concluded with other transition countries are even less committal than these. In 1994 and 1995, Partnership and Cooperation Agreements were signed with all of the CIS countries, while Trade and Cooperation Agreements have been entered into with Albania, Slovenia, Georgia, Armenia and Azerbaijan.

Assistance Programmes

The EU's assistance programmes for former members of the CMEA consist of "PHARE" for the Central and Eastern European countries and "TACIS" for the CIS. The PHARE programme was passed in December 1989, initially applying to the two pioneers in the transition process, namely Poland and Hungary. By 1992, the countries receiving the assistance included all 10 (as they then were)[11] Central and Eastern European countries. The funds made available via the programme were targeted in the key areas of privatization, agricultural reform, administrative and institutional reform, the reform of the social welfare system, education, healthcare, infrastructure, the environment, and nuclear safety. The set of instruments used includes the provision of expertise in all of the key areas listed, together with investment promotion by making both material and human capital available, which in turn entails the EU acting as a "broker" to bring together donors other than itself[12] with the countries receiving the support.[13] The programme is scheduled to run until 1999.

[7] Jürgen Stehn: Stufen einer Osterweiterung der Europäischen Union, in: Die Weltwirtschaft, No. 2, 1994, pp. 194–219.

[8] EU Commission: Agenda 2000, Vol. I, pp. 82 ff.

[9] Roxana Iorga, op. cit., p. 259.

[10] William Wallace: Current State and Future Prospects of the Euro-Atlantic Security Order, in: Gianni Bonvicini et al., op. cit., pp. 165 f.

[11] The number of participants increased accordingly when Czechoslovakia divided into two countries on 1st Jan. 1993.

[12] I.e. national and international financial institutions such as the EBRD, EIB, OECD, World Bank and IMF.

A total of ECU 5,250 million were made available between 1990 and 1995, as non-repayable, project-linked grants.[14] These funds were deployed in putting supply and service contracts out to tender. Tenders for the supply of materials were sought from enterprises in both the transition countries and the EU member states. Administrative bodies at a national level were only allowed to allot contracts freely up to a value of ECU 50,000, whereas the ceiling for service contracts was ECU 100,000. Another restriction was that all enterprises had to demonstrate a past record of success and a sufficient level of experience before being allowed to tender. Finally, all tender applicants needed to place themselves on the EU's PHARE/TACIS register, which acts as the Union's basis for selection.

TACIS is the support programme for the CIS, founded in 1990. The scheme first got under way with the "indicative programmes" instituted in the 1993–1995 period, designed to allow aid to be effectively concentrated and to provide a basis for annual action programmes.[15] A new set of TACIS regulations came into operation at the end of 1996, setting out the programme's objectives and frame conditions up to 1999. An annual sum of ECU 550 million is being provided over the four-year duration, corresponding to a total of ECU 2,200 million.

TACIS promotes human resources in all of the key areas of social and economic transition (the welfare system, education, administration, the economy and the law), as well as for privatization, infrastructure measures, power supply and nuclear safety, agricultural reforms, and securing an adequate supply of food.

Whereas PHARE provides its grants to specific projects, TACIS operates via the coordinating activities of the EU Commission and national coordinating bodies, which are normally the ministries or under-secretaries responsible for particular fields. The indicative or action programmes relating to specific sectors and regions are passed and released for operation by Directorate General I (external economic relations) and are subsequently implemented in collaboration with the CIS partner countries. Under a similar system to that of PHARE, service and supply contracts can only be freely issued by the Commission up to a certain limit. Tenders for contracts valued above that limit are usually invited under a restricted tendering system. Here too, any tendering organization must first be entered on the PHARE/TACIS register, since this is used by the Commission as the basis for allotting contracts. Most of the successful tenders for advisory services come from within the EU; however, an increasing proportion of contracts are now being awarded to tenderers from countries participating in PHARE, and approximately 20% to organizations within the TACIS zone.

In the early stages, the assistance programmes provided a veritable bonanza to Western advisors and consultants, and they were accompanied by extremely modest welfare effects in the actual countries supposedly benefiting from the programmes.[16] Lately, the pioneers among the transition countries have also begun to reap rewards as advisors, but domestic enterprises are still tending to "pull the short straw". Moreover, the scale of the funds provided can hardly be termed adequate in the light of the problems they are intended to solve. While the EU continues to spend half of its budget on an agricultural sector which has long since ceased to operate competitively, even at an optimistic estimate it appears prepared to shell out just 2% of its budget on assisting Eastern Europe's transition. Taking annual average figures as a basis, about ECU 875 million are deployed each year via PHARE, and approx. ECU 550 million via TACIS, making ECU 1,425 million in total, or less than one tenth the volume of the Structural Funds.

Deepening before Enlargement

The Treaty signed in Maastricht in early 1992 and the revisions incorporated into it by the Treaty of Amsterdam in June 1997 ("Maastricht II") are the culmination, for the time being, of European integration. The Treaty of Maastricht sets out objectives of the European Union that range beyond the economic sphere:

- ☐ to promote economic and social progress which is balanced and sustainable;
- ☐ to assert the Union's identity on the international scene, in particular through the implementation of a common foreign and security policy;
- ☐ to protect the rights and interests of the nationals of its Member States (Union citizenship);
- ☐ to cooperate on justice and home affairs;
- ☐ to maintain in full the *acquis communautaire*.[17]

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[13] EU Commission: PHARE. What is PHARE?, Brussels 1995.

[14] See the support guidelines set out in: EU Commission: PHARE. Programme and contract information 1995. Multi-country and cross-border programmes, No. 1, Brussels 1995.

[15] TACIS Information Office: TACIS. Summary of Indicative Programmes 1993-1995, Brussels.

[16] William Wallace, op. cit., p. 166.

[17] These objectives are defined under Title I of the Treaty of Maastricht ("Common Provisions"), Article B.

The wording of the Maastricht Treaty does not allow the conclusion that the Union should be responsible for all decision-making. Instead, powers are accorded by differing degrees to different levels of government. While all questions concerning Economic and Monetary Union are determined as Community policy, the powers in other fields of policy-making are allotted on a more varied basis, leaving it unclear how great the Union's powers should be. The Treaty explicitly refers to "common policy" on transport, foreign affairs, and agriculture and fisheries, to the EU making "a contribution" to healthcare policy, education, cultural development and energy policy, while it speaks of implementing "a policy" in the environmental and social fields.

The Maastricht Treaty was established on a dynamic basis, by providing (in Article N II) for an Inter-Governmental Conference (IGC) to review the Treaty's terms and ensure that its objectives are better implemented. The IGC was convened in Turin on 29th March 1996, when the following Agenda was laid down:

☐ an institutional reform and a Union closer to the citizens;[18]

☐ reinforcement of the Union's capacity for external action;

☐ close cooperation in the fields of combating organized crime, and policies on immigration and the granting of visas and political asylum.

The deepening of the Union, via the reform treaty that has still to be drawn up, is intended to take precedence over its enlargement in whatever form. In other words, issues of institutional reform such as the increased legitimacy of EU institutions vis-à-vis the general public and the creation of more transparent, more democratic structures within the Union, first need to be settled by the IGC. Even after Maastricht II, there is still no prospect of the basic institutional structure being redesigned by going as far as to establish a single state organized and acting along federal lines.

The compromises thrashed out in long-drawn-out negotiations and written into the Treaty of Amsterdam offer no guidance whatsoever as to how eastward enlargement should proceed. The only point on which the heads of state and of government were agreed was that the Treaty paved the way for entry negotiations to begin in 1998. Progress has been so limited, whether on reforming budgetary, agricultural and structural policy or on reshaping the Union's institutions, that it is difficult for any of the entry candidates to judge what they might have to deal with as part of an enlarged EU. The Commission has indeed now set about developing proposals (in its "Agenda 2000")[19] for the future budgetary structure, agricultural system and structural assistance; these proposals will then undergo the long-winded EU legislative process, and could not possibly reach completion by the time the entry candidates' negotiations get down to serious business in 1998. The reform of voting procedures in the Council of Ministers was not passed at Amsterdam, and was postponed until a further review conference takes place alongside the enlargement process.[20]

The effect of this is that fundamental decisions on the future of European integration are being taken without any involvement on the part of the entry candidates, and at the same time the entry candidates are being left in the dark as to how the future European Union will be structured, because their entry negotiations will take place in parallel to the EU's internal reform negotiations. Indeed, this situation also applies to the EMU debate. Depending on how strictly the convergence criteria are ultimately interpreted, a variety of heterogeneous structures ("core Europe", "variable geometry", etc.) are still conceivable for the different "layers" of the EU. What all this will mean for the entry candidates, and whether, and when, they will one day be able to participate in EMU which commences in 1999, has so far been left totally unclear.

The Union's Pre-Accession Strategy

Agenda 2000 deals with and analyses the enlargement project at some length. It begins by discussing three classes of entry criteria, namely:[21]

☐ political: e.g. democracy, the rule of law, human rights and the protection of minorities;

☐ economic: e.g. a properly functioning market economy, and the capability of withstanding the competitive pressures within the EU;

☐ others: e.g. the ability to pursue Union objectives

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[18] The issues dealt with under this heading, but still not yet resolved even after the Amsterdam Summit, include the introduction of majority voting in areas previously requiring unanimous agreement, a trimming down of procedures in the European Parliament, the composition of the Commission (with one commissioner per member state), the interpretation and application of the subsidiarity principle, the introduction of a schedule of fundamental rights, and the issue of a "multi-speed Europe".

[19] EU Commission: Agenda 2000 (3 vols.), DOC/97/6, Brussels, 15th July 1997.

[20] Frankfurter Allgemeine Zeitung, 19th June 1997, p. 6.

[21] EU Commission, Agenda 2000, op. cit., Vol. I, pp. 51 ff.

and EMU, and to adopt and apply the *acquis communautaire.*

All of the above serve as selection criteria, to filter out on an individual basis which of the transition countries have made the most progress. The conclusions emerging are exactly what one might expect, namely that Hungary, the Czech Republic and Poland are the three countries most likely to be in a position to join the Union, though there remains work to be done.

The main tasks needing to be tackled by entry candidates in the Commission's view are investment in environmental measures, transport, energy supply, industrial infrastructure and agriculture. It also operates on the assumption that agricultural prices in the entry-candidate countries, currently considerably lower, will be harmonized with Community levels, and that the current structural policy will be upheld. The Commission is demanding the removal of internal border controls and the implementation of Community environmental standards even before the countries concerned join the Union. Yet the EU is not willing to carry the cost of necessary environmental investment, and instead is recommending the development of long-term strategies and the involvement of foreign and private-sector capital sources. Similarly, in the transport field the Union is only prepared to foot the bill for the substantial adjustment costs involved in instances in which the investment can form part of the Trans-European Networks; when it comes to nuclear safety, the Commission suggests that funding be obtained from sources such as the EBRD, the World Bank, or the existing PHARE budget.[22]

The terms on which the candidate countries actually join the EU are to be laid down in their entry negotiations. In addition to adopting the *acquis communautaire* in full, it is also stressed that the new entrants would be expected to take on the rights and duties that EU membership entails:

"The new members should accept the basic obligations of accession, otherwise their right to participate fully in the decision-making process may be put in question."[23]

At the core of the EU's future behaviour towards the entry candidates will be its "intensified pre-accession strategy",[24] which coordinates the Union's assistance by way of "Accession Partnerships". The idea is to facilitate the pre-accession preparatory work, including drawing up a list of objectives and a time schedule, and to familiarize applicant countries with the way the Union operates by allowing them to participate in Union programmes.

These Accession Partnerships, in combination with additional agricultural and structural funding, are at the heart of the intensified pre-accession strategy:

"Accession Partnerships would involve:

☐ precise commitments on the part of the applicant country, relating in particular to democracy, macroeconomic stabilisation and nuclear safety, as well as a national programme for the adoption of the Community acquis ...

☐ mobilisation of all resources available to the Community for preparing the applicant countries for accession. ... Phare could be used as a catalyst for cofinancing operations with the EIB, the EBRD and the World Bank ..."[25]

One aspect of the Accession Partnerships that have commenced in the second half of 1997 is that annual progress reports must be submitted to the Commission from the end of 1998 onwards.

The Commission has been playing its cards close to its chest as far as PHARE funds are concerned. On the one hand, PHARE is supposed to remain the central instrument in the pre-accession phase. On the other, no firm statements have been made as to what funds will be available from 1999 onwards, and it is simply assumed that the budget will continue to rise after 2000. The additional money available from the other funds from 2000 onwards is currently set to be ECU 500 million per annum for the agricultural pre-accession strategy, and ECU 1,000 million per annum from the Structural Funds. Support will initially be given to all applicant countries, but later only those actually joining the EU will receive it.[26]

To broadly sum up the extensive Agenda 2000, it can safely be said that the Union has maintained its dominant stance in its relations with those aspiring to join. Indeed, in contrast to earlier negotiating rounds with applicant countries, it has even introduced additional surveillance mechanisms in the shape of the Accession Partnerships. Meanwhile, any references to the funding on offer have been extremely vague, and the amount of money involved could hardly be termed adequate to tackle the problems at hand. On the other hand, the EU is requiring entry candidates to invest huge amounts of their own

[22] Ibid., pp. 64 ff.

[23] Ibid., p. 73.

[24] Ibid., p. 74.

[25] Ibid., p. 76.

[26] EU Commission, Agenda 2000, op. cit., Vol. II, pp. 6 ff.

money. Thus it is extremely doubtful whether the benefits of accession will outweigh the costs, or in other words whether joining the EU can remain an attractive proposition for the Eastern European transition countries.

While the Union has declared its willingness to accept them as co-members in Agenda 2000, it has nevertheless dictated its own terms to the entry candidates. The predictable consequences of these tough terms in conjunction with weaker economic potential will be growing differentials both within the EU and in the European economic area as a whole.

Fragmentation into Groups

For a start, the deepening of the Union as currently envisaged will give rise to differences in membership status within the EU. One of the effects of the EMU project will be to delineate between the countries participating and those not participating in the common currency, by assigning certain newly-emerging decision-making powers accordingly. Thus the club of the strongest economies in the EU will also be able to take the most decisions. Yet the proportion of decisions made exclusively by the euro's initial participants will also be of fundamental significance for the future of the currency as such, for the second wave of participants, and for the future shape of the whole economic area. The EU will break down into at least three economically distinct groups, vested with different levels of powers, namely:

☐ *Core Europe:* The prospect is that EMU will commence in 1999. Only the EU's best-performing member states will participate. Thus the advantages of the common currency will be confined to the small group of countries able to comply with the convergence criteria set down in Article 109(j) of the Treaty of Maastricht, and thus able to play a part in all Union-level decisions.

☐ *The "outer core":* Member states with a medium-term prospect of joining EMU may be able to play a consultative role in EMU decision-making processes, and will continue as full members to participate in all other kinds of decisions.

☐ *The Single Market:* Current EU member states which only have a long-term prospect of EMU participation will, in the first instance, not even have consultative status in EMU decision-making, and will only participate in decisions taken in the EU's other areas of operation.

The EU's enlargement strategy as presented in Agenda 2000 will also give rise to further distinctions in the Eastern European economic area. It is, after all, inconceivable that all of the ex-CMEA countries could accede to the EU, and since negotiations are currently only being sought with five of the ten countries that have lodged applications, the transition countries also break down into at least three different groups:

☐ *The EU periphery:* The potential EU member states, which are not about to be EMU participants and indeed would not take part in all policy areas, would only be allowed to share in the decision-making processes in the particular fields in which they are integrated. Within this group, it is possible that different entry candidates may eventually participate in slightly different ways: this would add yet another twist to the "multi-speed Europe".

☐ *Intermediate Europe:* This group will consist of the transition countries that are seeking EU entry but which will not attain it in the medium-to-long term.

☐ *Marginal Europe:* The transition countries that have no desire to join the EU, and would not be able to even in the long term, and hence would not be integrated into any form of institutionalized economic structure.

It is still uncertain what institutional form the EU would ultimately take if the transition countries were to join it. It is quite evident that the Union would, by then if not before, be compelled to depart from its present "rigid geometry". Yet no matter what variable constitutional arrangements are developed for the EU, these would be certain to impair its effectiveness. The idea that the EU might be capable of meeting the "Eastern European challenge" (which, taken at its extreme, would entail a doubling of its membership) without having to completely reconstruct the *acquis communautaire* and the institutional framework, is an illusion which present EU governments are fond of fostering.[27] Unfortunately though, that does not bring the notion any closer to the truth. The EU, having acted as a symbol of prosperity up to now, will no longer have the capacity to exert a welfare-enhancing influence on all member states on an equal basis: the best it will manage is to raise utility for a country on the basis of its specific status and the degree to which it is integrated into the Community, which will differ from one member to another. In other words, the more integrated a country is, the greater the benefits it will gain. Given that the most closely integrated countries will be those that already have the strongest economies, and that they will attain the greatest economic benefits, existing differentials within the EU will be accentuated over time.

[27] William Wallace, op. cit., p. 158.

Meanwhile, the group of Western countries will be unwilling to weaken their own position by only accepting net recipients as new members in their club. Indeed, even if the West were prepared to make financial sacrifices to provide material assistance to the East, marked prosperity differentials would still make themselves felt, as the integration of former East Germany into the EU has demonstrated. Thus there would be a substantial increase in the number of regions and the proportion of the population with relatively low living standards.

The accession of the transition economies and the resulting accentuation of prosperity differentials is in fact more likely to destabilize and weaken the EU's internal institutional structures than it is to generate the opposite effect of lending greater stability to the new member states.

In the debate on EU enlargement, we normally tend to completely forget countries that neither wish, nor are being invited, to seek EU membership, or those which would like to join but have no prospect of doing so for the foreseeable future.[28] The Visegrád countries and the Baltic states do indeed stand a chance of becoming EU members, whereas it is unclear what chances the countries to the east of the first-wave applicants might have. This group includes Russia and the CIS, but also Romania, Bulgaria, Ukraine and Belarus. It will take decades before these countries can come anywhere near attaining a level suitable for EU entry, and during that time they will be expected to remain at the margins of the structures of prosperity that the West has built up. These countries have quite a long way to go even to get back to the levels of GDP they attained in 1989. And the road they have to travel will be made the longer and the more difficult by having to do so in the company of other "transition laggards" instead of being able to join forces with all the other ex-CMEA countries.

Besides, it is not yet clear when the five countries at the vanguard of the transition, negotiations with which are to begin this year, will actually be accepted into the fold of the EU, but it would be quite realistic to expect another decade to elapse before their eventual accession. These precursors of reform would be well advised to make best use of this important period for their own economic development, by also entering into other forms of economically beneficial cooperation.

[28] One such example is Ukraine which, though it has no desire to join NATO, does wish to become a member state of the EU (Frankfurter Allgemeine Zeitung, 4th March 1997, p. 6).

Phased Cooperation

For the reasons discussed above, a phased cooperation between the EU and Eastern Europe is the only realistic vision of the future, whether in political or in economic terms. Whether the phases are developed partly inside the EU (under the guise of "asymmetrical geometry") or, as would be a truer reflection of the real situation, between two substantially different economic zones within Europe, is ultimately a question of the EU's own seriousness and sincerity in its dealings with the transition countries. In the interests of solving the problems now prevailing, an alternative ought to be found to the transition countries' present preoccupation with belonging to the West. This alternative approach ought to provide the transition countries with an institutional backbone and to allow them to pursue economic policies that will promote modernization. The arrangement could then, in turn, ease the countries' path towards EU accession.

The Central European Free Trade Area (CEFTA), which so far has been of little relevance, could admit new members and model its operation on that of EFTA. The effect would be to develop a free trade area covering all of Eastern Europe; while there would be no more internal tariffs, each member country would remain free to determine its own external tariffs. Considering the marked decline in trade among the Eastern European countries while wide areas of them are still under-supplied with basic requirements, this would allow a trading zone to develop that is not being served by Western countries, whether because their products are too expensive or because the informal barriers to trade are too great. Precisely because the countries in this region are in a similar situation and share a similar past, if they could once overcome their "CMEA trauma" and focus on their economic development, they should be in a position to mutually develop this market for their low-priced products by establishing a free trade area. Even if the quality of the goods traded were relatively low to begin with, it would suffice to fulfil the public's basic needs and the trade would substantially boost overall economic welfare. The overall fall in transaction costs (particularly the free movement of goods from one member country to another) might also attract Western investors, thus raising productivity in the transition economies when modern plant is installed.

At the same time, a genuine free trade area could emphasize aspects in relations with third countries which would be important for the development of small industries with future prospects. By acting as a single, united body, the free trade area would be able to carry more weight in negotiations with the EU and, as EFTA has done in the past, it would be able to guide its members in concluding bilateral free trade agreements with the EU for commercial and industrial goods.

The external tariffs differing from one country, and one sector, to another could assist by protecting still relatively uncompetitive areas of an economy against foreign competition, particularly from nearby Western countries, while the Central and Eastern European countries are undergoing the necessary modernization. On this basis, two European economic zones would be able to cooperate on equal terms, thus allowing the interests of the transition countries to be more fully considered than they have been in relations to date.

This proposal is not implying that East-West interaction ought to be reduced. On the contrary, the West ought to continue offering its assistance, but ought to take more steps to allow local labour to benefit from the measures taken.

In trade agreements concluded on a similar basis to their EFTA-EU counterparts, the countries joining together in CEFTA could be granted free access to the EU's markets for all of their manufacturing industry. "Sensitive areas" would no longer enjoy protection, and the Eastern Europeans would be able to play out their comparative advantage in labour costs to the full.

The countries might then be able to adapt to the Community *acquis* and develop a long-term option to join the Union in parallel to the process of developing their economic strength. The advantage of this approach would be that rules would evolve over time instead of having a set of standards imposed which have not grown organically within a country's own system, as envisaged by the current accession strategy. Countries would be able to make a gradual approach to the standards of the European Economic Area, in which all Single Market rules apply, and which has served in the past as a preparatory stage on the way to EU accession.

In the short and medium terms, then, a free trade area would be a suitable institutional arrangement to act as a counterweight to the EU in Eastern Europe, promoting economic cooperation there, facilitating the common transition to a market economy,[29] and paving the way for EU entry in the long term by way of confidence-building trading activity.

[29] Patricia Bauer: *Probleme der ökonomischen Transformation Gesamteuropas*, in: Berthold Meyer, Bernhard Moltmann (eds.): Neuer Osten – Alter Westen. Die europäischen Staaten zwischen Annäherung und Distanz, Frankfurt am Main 1996, pp. 76-107.

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The Explanatory Value of Neo-Institutionalism: Some Examples from Development Financing

Proponents of New Institutional Economics claim, among other things, that NIE forms the basis for a new theory of development financing. This article explains the differences between neo-institutional approaches and other theories of development financing. It shows that there is a link between the modelling assumptions of neo-classicism in general and NIE in particular and a correspondence between the two in their understanding of institutions and their recommendations of institutional reforms. A number of conclusions are drawn for the orientation of official development co-operation.

It is not generally very difficult to call into question the policy recommendations of a particular school of theory, and development financing and the reforms proposed by neo-institutionalists are no exceptions. The main objective of this article is to examine the methodological basis for neo-institutional explanations and proposals in order to make it easier to understand the limitations on the applicability of this new paradigm.

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