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East-West Integration

1 Introduction

Wars in Europe have taken a tremendous toll on human life and property. The rejection of Communism eliminated one source of potential conflict; Above all, it was the East's desire to share Western affluence and democracy that forced this rejection. Integration and reconstruction are under way, but the outcome is still uncertain. The right kind of trading system could accelerate Eastern transformations; it would quicken Eastern growth and necessarily involve democratic and pro-market reforms. Furthermore, the growing spending power of hundreds of millions of Eastern consumers would offer vast opportunities for West European businesses. All in all, an economic success story would stimulate prosperity and peace throughout the continent. The wrong kind of trading system, on the other hand, could frustrate Eastern aspirations for joining Europe. Prolonged economic distress creates political turmoil. Indeed, democracy and capitalism create risks in part of Europe. History and geography dictate that this is a continent-wide problem. Pan-European war is the worse kind of scenario. Any serious unrest or conflict, even if it takes place only in the East, could also harm Western Europe. The West can do little to help fulfil these reformist desires; the East will have to bear the brunt of the pain and effort. Building a sensible path towards European integration is one way Western Europe can help. This should be the priority.

The current trading arrangements in Europe are developing gradually. They are driven by urgency, by short-term political considerations and by economic advantage. In the background there is the goal of an integrated Europe, the intention of most European countries not yet in the Union to join it as soon as possible.

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The subject of this article is East-West integration. Part two examines the issue of integration between East and West by introducing the club theory as applied to international relations. The general assumption of the club theory is that the costs and benefits are a function of the size of the club and that the club size will be expanded till the marginal costs equal the marginal benefits. Part three examines the concrete benefits and costs of EU enlargement. There are economic and political gains, budgetary costs, voting and migration effects involved in the integration between East and West. Finally, part four discusses visions and realism of further integration and suggestions for interim policies while achieving an integrated Europe.

2 East-West integration - a club theory approach

Lively debate has arisen out of the decisions of the former centrally planned economies to adopt market-based and open economic systems. The debate has focused mainly on the great efforts, difficulties and costs that such a process requires. Some attention has also been focused on the role that Western countries should play. Western aid and freer trade have been proposed as has the possibility of future European Union membership and other forms of closer cooperation.

In this section we examine the issue of integration between East and West by introducing the club theory as applied to international relations[1]. The Western side consists of the 15 countries of the European Union: Germany, France, Italy, the United Kingdom, Spain, Belgium, the Netherlands, Luxemburg, Greece, Portugal, Ireland, Austria, Denmark, Sweden and Finland. The Eastern side includes both the Central and Eastern European countries and the Common Independent States.

The club theory constitutes the basic framework, and we argue that in the long run, integration of the Eastern economies will require economic and institutional adjustment in both parts of Europe.

Club theory has been applied to a wide variety of areas, including some cases of international cooperation. How do we define a "club"? A club is a voluntary group deriving mutual benefit from sharing one or more of the following: **production costs**, **the member's characteristics**, or **a good characterized by excludable benefits**[2]. A number of aspects of the club definition deserve highlighting. First, clubs must be voluntary; members choose to belong because they anticipate benefit from membership. Thus, the utility jointly derived from membership and the consumption of other goods must exceed the utility associated with nonmembership. Second, clubs involve sharing, whether it is the use of a public good or the enjoyment of the desirable attributes of the members. Sharing often leads to a partial rivalry of benefits as larger memberships crowd one another, causing a decline in the quality of the services received. Third, there is an exclusion mechanism, whereby the users' rates of utilization can be monitored and nonmembers and nonpayers can be barred. Without such a mechanism, there would be no incentives for members to join and to pay dues and other fees. Fourth, a homogenous club includes members whose tastes and endowments are identical. If either tastes or endowments differ, then the club is called heterogenous or mixed.

Trade agreements can be seen as clubs, in which the opportunity to take a free ride is limited and there is an almost complete possibility of exclusion of nonmembers from the benefits of joining the club.

The European Union is more than just a trade club; its members share a common tariff policy and a common policy in a form of the Single Market Programme (SMP). The SMP includes common competition rules and standards within the EU, thereby

[1] Luca De Benedictis - Pier Carlo Padoan (1991) **CIDEI Working Paper.** Centro Interdipartimentale di Economia Internazionale Universita di Roma, "La Sapienza".

[2] Cornes, Richard - Sandler, Todd (1986) **The Theory of Externalities, Public Goods and Club Goods.** Cambridge University Press, p.159.

providing extra public goods to its members[3]. In this respect, the EU is an example of an "industryclub"; to guide its members' internal and external behaviour it provides them a number of public goods.

To explain the formation of international organizations, we start from a model that is a version of a club model introduced by Fratianni and Pattison (1982)[4]. The general assumption is that **costs and benefits are a function of the size of the club** (Q). In the case of an "industryclub", this can be measured both by the **countries involved** and **the extent of market liberalization** within and between membercountries.

In joining a club, country i will maximize its net benefits, Gi. This is the difference between benefits and costs. Since

$$Gi(Q) = bi(Q) - ci(Q) \qquad (1)$$

the maximization of benefits for a single country, Gi implies

$$dGi/dQ = dbi/dQ - dci/dQ = 0 \qquad (2)$$

Assuming that the share of total benefits bt for the individual country is Bi = bi/bt and that policies will not alter the share so that bi = Bibt, we get

$$dbi/dQ = Bi(dbt/dQ) \qquad (3)$$

and it follows that

$$Bi(dbt/dQ) = dci/dQ \qquad (4)$$

Equation (4) represents the optimum amount of cooperation for country i. For the club as a whole the optimum amount of cooperation is reached when the marginal costs and marginal benefits are equalized for the club:

$$dbt/dQ = dc/dQ \qquad (5)$$

As is usual in club theory we assume that marginal benefits[5] decline and marginal costs rise with club size, so that a solution is guaranteed as described in Figure 1. Marginal costs increase because of the extra amount of club good provided by larger number of members. Moreover, as Fratianni and Pattison (1982) note, decision theory implies that an increase in the number of members will raise the costs of finding agreements in a more than proportional manner. Further, organizational and

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[3] A club shares a particular type of public good characterized by excludable benefits. They cannot be divided among individuals owing to nonrivalry of benefits and nonexcludability problems. They are benefits simultaneously received by more than one individual (e.g., swimming pools, golf courses, highways, defence system, trade system, etc.). Cornes, Richard - Sandler, Todd (1986) **The Theory of Externalities, Public Goods, and Club Goods.** Cambridge University Press.

[4] Fratianni, M. - Pattison, J. (1982) **The Economics of international organizations.** Kyklos, Vol.35.

[5] Marginal benefits/marginal costs = benefits/costs resulting from adding one more member to the club.

political factors will also raise costs more than proportionally, and institutional arrangements will change the behaviour of costs. For example, a shift from unanimity rule to majority rule in decision-making within the club will lower marginal costs; MC_1 shifts to MC_2 in Figure 1.

We shall now proceed to discuss a club enlargement problem having the EU on one side and Eastern Europe on the other. We start from the assumption that the European Union is a club equilibrium, where MC = MB. If MB < MC then the club is too large and there is no incentive for the EU to accept new members. If, on the other hand, MB > MC then the club is too small and new members would be considered beneficial from the Union's point of view.

In the East, a programme of transition to a market system and integration with the West represents both a great challenge and a great opportunity. The challenge is the high costs the East will have to bear in order to accomplish full market integration. The opportunity arises from the larger markets and benefits received as a member of the EU. In the EU, in the West, there are also risks, challenges and opportunities involved. Again, the risks lie in the costs brought about by membership of Eastern countries. The opportunity arises from the large market that the addition of the East would represent for Western industrialized countries. The opportunity and the costs can be seen graphically in Figure 2.

Point A, the intersection of MB and MC, defines the initial equilibrium point. Further enlargement would cause MC to rise and MB to decrease. Costs would increase due to new membership (even if partial conditions such as association agreements were involved) since the amount of negotiation required (on both sides) would increase. At the beginning of the process, there is no support for club enlargement, since MB < MC. However, at higher levels of Q, marginal benefits for club members start to rise and exceed the marginal costs. This happens due to enlarged membership and deeper market liberalization. During this transition period benefits would finally increase if we accept the assumption that inclusion of the East within the Union represents the opportunity in terms of market exploitation that a larger integrated area creates for all participants.

At point B, MB = MC again. However, this is an unstable equilibrium, because MB is still rising on the right side of point B. This means that there is a rising incentive to expand the club by admitting new members and completing their market liberalization process. After some time there are too many member-candidates willing to join the Union, causing MB to decrease to point C. Point C represents the new club equilibrium - the "Greater Europe".

An important area is the one between A and B. In this region MB < MC, implying that there is no interest in expanding the club, but only in returning to point A. The area between points A and B represents the situation of initial adjustment - the adjustment problem - and can be thought of as the present situation; immediate EU membership for the Eastern countries is absolutely out of the question.

Figure 2. also indicates that the adjustment problem requires a) club size, b) marginal costs and c) marginal benefits to be beyond point B before integration can begin and lead to point C. A contribution to the start can come from a change in both benefit and cost behaviour in the club.

The MC curve can be shifted downward (from MC_1 to MC_2) by, for example, loosening the voting rule (i.e. moving from unanimity to majority rule). This would move the unstable equilibrium point from B to D and narrow the transition region. Moreover, an acceleration of the market liberalization process and improvement of access to the Western market can shift the MB curve upwards, from MB_1 to MB_2. This shift would move the unstable equilibrium point to the left, point E.

As mentioned earlier, the general assumption of the club theory is that the costs and benefits are a function of the size of the club and that the club size will be expanded till the marginal costs equal the marginal benefits. We shall therefore now discuss the **incentives** and the major **obstacles** to further integration in more detail.

3 Benefits and difficulties of further integration

3.1 Overview

Enlargement of the European Union to the East is now certain, but its timing is not. Enlargement of the EU will take place on a case-by-case basis. The massive liberalization entailed by EU enlargement would probably bring major long-run economic benefits to the whole of Europe. However, the question arises whether the current design of major EU institutions is capable of coping with such a large membership.

Before turning to benefits and difficulties in more detail, it is necessary to present some definitions. **Enlargement** itself implies the prospect of future EU membership, though without any definite time schedule[6]. This objective has been recognized in the Association Agreements between European Union and Central and Eastern European countries. However, the Partnership and Cooperation Agreements governing EU trade relations with Russia, Ukraine, Moldova, Belarus, Kazakstan and Kyrgystan do not yet include recognition of such an objective. Therefore, when talking about Russia and the Common Independent States, we shall apply the word **integration** as a wider concept including Partnership and Cooperation Agreements and all other arrangements that aim at closer economic and political cooperation. In other words, enlargement and integration are seen not only as a process towards full membership but also as an increasing political dialogue and economic cooperation between the EU and the countries of Eastern Europe.

The club theory says that the existing adjustment problem implies that immediate EU membership is impossible for the Eastern economies. To start the process that leads to complete integration, the club size, marginal costs and marginal benefits have to change. A contribution to the start can come both from a change in benefit and cost behaviour in the club.

In this part we discuss more concretely the costs and benefits involved in Eastern integration with the EU. The greater political benefits and economic gains due to both the increased market liberalization and the larger number of members will comprise the benefits discussed. As we can see from Figure 2, they increase the marginal benefits from MB_1 to MB_2, thereby reducing the adjustment problem (the area from A to B). Thus, the process leading to complete integration could start earlier.

Budgetary, voting and migration effects represent the other, more difficult side of the story. They affect the marginal costs. Increased costs shift the MC curve in Figure 2 from MC_2 to MC_1. This adds to the adjustment problem.

Only when the size of the Union and the marginal costs and marginal benefits are beyond point B, can the integrating process leading to point C begin. In other words, the process leading to complete integration can start because the benefits resulting from it are greater than the costs. Finally, once the marginal costs and marginal benefits are equal, the Union has reached its optimal size.

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[6] Jouko Rautava (1994) **EC Integration: Does It Mean East-West Disintegration.** Review of Economies in Transition 3/1994, Bank of Finland.

3.2 Economic Gains

No matter what the motives for integration are, it is still necessary to analyse the economic implications of such geographically discriminatory groupings. If we concentrate on the main functions of the EU, the obvious economic implications can be summarized as follows: Participation in the Single Market provides a country the opportunity to reallocate its resources and to improve its national welfare by realising "gains from trade" with the EU. Furthermore, relatively poor countries have the opportunity to increase their welfare by participating in the distributional mechanisms of the Treaty, which are based on the common agricultural policy and on the EU's structural funds.

If we take a closer look, the effects of market opening can be classified into allocation, growth and location.

Allocation effects concern **the efficiency with which an economy allocates its resources among various sectors**. Market-determined prices guide resource allocation in a market economy. Barriers that hinder competition and interfere with the market determination of prices tend to distort price-based communication between producers and consumers. As a consequence, distorted prices lead to a confused and inefficient allocation of resources in Europe. Barriers to the international exchange of goods, services and productive factors are a prime example of such interference. By removing such barriers an Eastern enlargement of the EU would improve the efficiency with which the resources are allocated. Furthermore, removing such barriers will lead to equalized prices of goods, services and factors between the East and the West. While this usually generates a net gain in welfare, it also leads to a large redistribution of income.

Growth effects involve **the rate at which productive factors accumulate**. Maintained growth in output requires the sustained accumulation of some factor or factors of production. In order to increase the amount of output per capita continually, an economy must continually accumulate human capital, physical capital and/or knowledge capital. In a market economy, this endless accumulation is the result of investment decisions made primarily by self-interested private agents. For example, students invest their time and money in their own education primarily to increase their own income. Similarly, firms try to raise profits by training their workers, lowering costs or increasing output. They also develop new products and new production methods, again to increase profits. All in all, the net result of these private decisions is a rate of accumulation that results in a rate of GDP growth. Policies that improve the efficiency of resource-allocation often tend to improve the investment climate as well. Consequently, the radical market liberalization implied by EU enlargement eastwards is most likely to increase growth throughout Europe.

Finally, **location effects concentrate on the geographical allocation of existing resources**. The focus is on the distribution of economic activity; the complexity between concentration and liberalization. On the one hand, prohibitive barriers lead to the total decentralization of production - in this case, liberalization is accompanied by increased concentration of production in large markets. On the other hand, the location of production is evenly dispersed when there are no costs to trading, and liberalization is accompanied by a decrease in concentration. In general, is rather difficult to say much about the direction of the location effects of an EU enlargement. However, one thing is obvious: some Eastern countries are closer to Europe's economic centre of gravity than many present EU members. Moreover, the economic centre of Europe will presumably move eastward as the average incomes of Easterners catch up with Western levels.

All in all, the economic gains depend basically on the way in which integration increases opportunities for producers and consumers to organize their affairs more efficiently. At the customs union (and free trade area) level, the possible sources of economic gain are as follows. First, integration results in enhanced efficiency of production through increased specialization in accordance with the law of comparative advantage. Levels of production will be increased due to better exploitation of economies of scale made possible by the increased size of the market. Furthermore, the international bargaining position will be improved as a result of the larger size, and will lead to better terms of trade (price of exports divided by price of imports). Competition will also be enhanced due to enforced changes in economic efficiency. Finally, there will most likely be changes affecting both the number and quality of the factors of production due to technological advances.

If the level of economic integration is to proceed beyond the customs union level to the economic union level, then further sources of gain become possible due to factor mobility across the borders of member nations, co-ordination of monetary and fiscal policies and unification of the goals of near full employment, higher rates of economic growth and better income distribution.

3.3 Political Benefits

In reality, almost all existing cases of economic integration have been proposed or formed for political reasons, even though the popular arguments have emphasized the possible economic gains. There is, nevertheless, clearly a close interconnection between politics and economics in the evolution of regions and societies.

Political benefits can vary depending on the stage of integration, be it cooperation or full membership. From the perspective of full membership, the political implications of EU membership go beyond the core economic implications. Interesting in this regard is the impact of membership on the power balance among the different national interest groups, lobbies and governments. It seems quite obvious that signing the Treaty will considerably reduce the power of national policymakers. For example, after EU membership a country can no longer determine its own foreign trade policy. The traditional tools to protect both demand and supply are no longer available since the country is obliged to follow the EU's overall trade policy. As a result, government subsidies, tariffs, monopoly rents and other trade restrictions are reduced.

From the perspective of non-membership, the political implications of increasing integration and continuing cooperation may be in the form of increased security worldwide; countries in the East of Europe, including Central and East European countries, Russia and the other newly-independent states, have recently started the process towards democracy and a market economy. However, these changes are not irreversible; internal and external forces could reverse the situation. The evolution of democratic institutions and the continuing promotion of economic reform therefore requires, most of all, a reduction in the scope for conflict. Under these circumstances, Western assistance, increased economic cooperation and political dialogue between the EU and countries in the East of Europe would provide support for the ongoing development process and thus support the Union's prime objective, which is to maintain stability in the region.

However, on the other hand, nobody can be entirely sure whether close relationships with the EU, or even EU membership itself, would help with security and political equilibrium. For example, there is considerable doubt about the willingness of most EU member states to get involved militarily in foreign countries. In addition, it would seem difficult, if not impossible, to obtain the consent of all the nations of the European Union to joint military action.

All in all, the main advantage of EU membership is that it guarantees an efficient allocation of resources, as it greatly reduces the power of national producer lobbies, dominating interest groups and the potential for state intervention. Furthermore, the main advantage of continuing integration and closer cooperation with nonmembers is maintaining the ongoing transition process in the East and a stable political climate worldwide.

3.4 Direct budgetary costs

There are over 100 million people living in Central and Eastern Europe and almost 300 million in the area of the former Soviet Union. These 400 million consumers, savers, workers are currently poorer than the 370 million in Western Europe[7]. Thus, the Eastern economies are currently seen as too populous, too poor and also too agricultural to enter the EU without drastically altering the Union itself. Keeping the club theory in mind, we will now discuss the difficulties involved in the integration of the EU with the East, by first introducing the problem of direct budgetary costs. We will show that any enlargement of the EU to the East would have a large, though perhaps too radical, impact on the Union's budget. The budget discussion presented here is mainly based on data from the CEPR (1992, 1994)[8]. We shall first focus on the main features of the EU's budget and then turn to the budgetary effects of Eastern integration.

Table 1. shows that two items dominate the spending side of the EU budget. These are the Structural Funds and Common Agricultural Policy (CAP) which account for over 80 % of all EU spending. As they are important items in the budget, they also play an important role in the Union. These programmes provide help to various groups and regions in their adjustment to changes caused by integration.

Structural Funds are large transfers to the poorest member states and regions. They are aimed at encouraging greater economic and social cohesion that is at narrowing the gap between per capita income levels. The first objective group includes regions with per capita incomes of less than 75 % of the EU average. Spending within this objective is aimed at improving infrastructure and local training. The second objective group includes regions that suffer from decline in traditional industries such as coal and steel. The spending objective here is to create jobs, improve the environment, develop R&D and renovate buildings and land. The

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[7] See Table 4. Per capita Income Levels.

[8] **Monitoring European Integration, Is Bigger Better?** (1994) The Economics of EC Enlargement, CEPR 1992 London & Richard Baldwin, Towards an Integrated Europe, CEPR. London.

remaining objectives concern, for instance, long-term unemployed, unemployed youth and underdeveloped farms.

Table 1. **EU budget 1992, (ECU billion)**[9]

Revenue		*Spending*	
VAT	58.0	CAP	53.7
Tariffs	18.9	Structural Funds	31.6
Agricultural levies	3.3	R&D, energy and technology	3.3
GNP based	13.9	Administration	4.7
Other	5.8	Foreign aid	3.5
		Other	1.3
Total ECU billion	59.7	*Total* ECU billion	58.1

For our purpose, the most important aspect of these expenditures is their close link with per capita incomes. This is close connected with the issue of projecting the budgetary cost of EU enlargement because incomes are low in the East European countries.

The CAP is a very complex and expensive set of policies. Its aim is to support and raise the incomes and output of the EU farm sector. More than half of the support is paid for directly by consumers via the "hidden tax" of protectionism (note that import barriers keep prices above free trade prices, thereby transferring income from consumers to producers). The rest of the support is paid for by the European Agriculture Guidance and Guarantee Fund (EAGGF). The guidance section of the Fund finances improvement in the structure of the Union's agricultural sector. The guarantee section, in turn, finances guaranteed minimum prices for most food products by buying food in EU markets, restricting imports, subsidizing exports and to some extent by limiting production.

On the revenue side, there are four main sources. The most important is based on national VAT receipts. It has been agreed that each member pays a slice of its VAT revenue to the Union. The second and third sources consist of tariff revenue and agricultural levies collected on imports from non-EU countries. Under EU rules, these revenues accrue directly to the EU. The fourth major income source is the revenue that members pay based on their GNPs.

We have now briefly covered the main features of the EU's budget. The next task is to project the receipts and contributions that Eastern countries would possibly make as EU members. Calculations are based on a situation including only the Visegrad countries. The task is extremely difficult and involves a great amount of guesswork. We shall not concentrate on details since data from Eastern countries

[9] Courchene, T. et al. (1993) **Stable Money - Sound Finances.** European Economy, No.53.

tends to be inaccurate, incomplete and constantly changing. Instead, only approximations will be presented below.

Since the CAP accounts for about half of EU spending, the accuracy of any estimate of budget costs relies heavily on the estimate of CAP costs. Allowing Eastern farmers into the CAP would be costly for several reasons. The CAP food prices and production subsidies would encourage agricultural production in the East. This also implies that Eastern consumers would face higher prices. The Eastern group's combined output of farm products would be higher than under the non-membership scenario. In order to maintain EU food prices, increased production should be accompanied by increased exports. Thus, apart from production subsidies, the EU would have to provide large export subsidies for the excess food. Naturally, dumping this extra food on the world market would later depress world food prices. Furthermore, the lower prices would also make it more expensive to subsidize the export of EU members' surplus food.

Another interesting way to examine the budgetary impact of an Eastern enlargement is the approach presented by David Beggs. Begg's model separates EU expenditures into Structural Funds and CAP payments. His model of cohesion spending makes use of the close correlation between per capita income, the share of agriculture in GDP and per capita receipts of Structural Funds. The main message of Begg's model is that member countries' CAP receipts rise in proportion to agricultural output. Begg also calculates the long-term budgetary cost of an Eastern enlargement, allowing for a doubling of Eastern income levels. He finds, however, that this does not lower the budgetary cost but actually raises it. This is obviously a surprising result. The reason is the assumption that agriculture would remain a constant fraction of total GDP. Thus rising incomes lead to lower Structural Fund transfers and higher contributions. Furthermore, rising incomes also lead to higher agricultural output and thus more CAP receipts. Given the higher agriculture shares in these economies, the latter will outweight the former.

Projecting the receipts and contributions that Eastern nations would make as EU members is an extremely difficult task. So is the task of estimating the timescale required to achieve budget neutrality. However, to give some idea, we shall consider some simple but instructive calculations and present the following example of the budgetary impact of the Visegrad countries joining the EU.

The largest structural spending programme draws the line at regions with per capita incomes that are less than 75 % of the EU average. Table 2 shows how many years it would take the Visegrad group to rise above this cut-off point, assuming that the EU average rises at 2 % per annum.

Few countries have managed to sustain 6 % growth for extended periods, although it may be possible for the most successful CEECs. Under this optimistic assumption, it would take two decades for the average income of the Visegrad-4 group to rise above current criteria for structural spending. Taken individually, both Poland and Hungary would take approximately two decades, but the Czech Republic would take only 14 years. Slovakia is an outlier at 26 years. Allowing for more moderate growth rates implies substantially longer catch-up times. At 4 %, the Visegrad average would take three decades to catch up and at 3 % growth four decades would be required.

Table 2. **Years for the Visegrad group to catch up to 75 % of EU average income**[10]

	3 % CEEC growth	4 % CEEC growth	6 % CEEC growth
Czech Republic	28	21	14
Hungary	35	26	18
Slovakia	51	39	26
Poland	44	33	22
Visegrad-4 average	40	30	20

Very careful estimates of the cost of allowing the Visegrad-4 to join the EU are presented by Anderson and Tyers (1993) in Table 3.

Table 3. **Budgetary cost of admitting the Visegrad-4 in 2000 (ECU billion)**[11]

Budget	CAP cost	Structural funds cost	Contribution	Net cost
Visegrad group	37.6	26.0	5.5	58.1

Anderson and Tyers (1993) estimate that the total extra cost to the EU CAP budget would amount to USD 47 billion each year. The extra cost of Visegrad membership would be ECU 37.6 billion (using an exchange rate of 1.25) and would simply bankrupt the CAP. For comparison, total CAP spending levels in 1991, 1992 and 1993 are ECU 31.0 billion, 31.2 billion and 35.1 billion respectively.

Furthermore, the estimate also suggests that the Visegrad-4 would receive ECU 26 billion in Structural Funds. Again, for comparison, in 1993 the four poorest members received about ECU 16 billion.

Using the 1.3 % contribution figure, it is straightforward to calculate the contribution the Visegrad group would make as members in 2000. According to World Bank figures, the Visegrad GDP was about USD 340 billion in 1991. Under

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[10] Note: assumes 2 % growth of EU average income. Baldwin et al. 1992. Baldwin (1994) **Towards an Integrated Europe.** Centre for Economic Policy Research, London.

[11] Anderson, K. - Tyers, R. (1993) **Implications of EC expansion for European agricultural policies, trade and welfare.** CEPR Discussion paper No.829, London. Structural Funds costs from EC Commission 1993.

these assumptions, a 4 % real growth rate yields a 2000 Visegrad GDP of USD 482 billion and a 6 % real growth rate produces a figure of USD 573 billion. Thus, the gross contribution of the new entrants would be between USD 6.3 and USD 7.5 billion. Using an exchange rate of 1.25, contributions would be between ECU 5 and 6 billion.

Adding everything together, the net budget cost would be ECU 58.1 billion. According to the EU Commission, the EU's total budget in 1999 is projected to be about ECU 86 billion. Thus, given these estimates, the Visegrad enlargement, with no change in expenditure policies, would force an increase in the EU budget of 68 %.

The basic message of the preceding analysis is that the budgetary burden on an enlargement is an important obstacle to EU membership for the East European countries. Since the level of national income is an important determinant of receipts and the national contributions, and many Eastern countries are expected to grow rapidly in the coming decades, it would be very interesting to know how many years would be required for each of the Eastern countries to reach budget neutrality. Moreover, the period to budget neutrality is systematically lower for the high, non-agriculture growth rates, since receipts fall and contributions rise as income increases. All in all, the most likely outcome is that some Eastern countries will grow rapidly, others slowly and some not at all. Unfortunately, the best estimates of the budget costs are not flexible enough for this sort of "what if" speculation. Under these circumstances, we can only rely on the less satisfactory budget-projection methodologies described above.

3.5 Voting effects

The implications of allowing voting rights to new members are important and can be both unexpected and costly. Can we predict the consequences of granting the Eastern countries the right to vote on Union matters? It is clear that as EU members, the Eastern countries would use their power to secure benefits for their electorates. For example, France used this power to raise protection and subsidies for her farmers, as did the United Kingdom to get a rebate on its contribution. So, Eastern countries could not be expected to be any different. If accepted as full EU members, they would have the right to vote on issues from a common defence policy to reform of the CAP. Under current practices, EU members are accorded votes in relation to their populations; small countries have a disproportionately higher number of votes. Since there are hundreds of millions of East European citizens, the East would have an important number of votes, with significant implications for politics in the Union[12].

These observations encourage and reinforce the belief that EU voting procedures should be reconsidered before any substantial enlargement occurs. Indeed, changing the rules has been under serious consideration in recent discussions. The voting rules of the Council of Ministers (the main decision-maker in the EU) are complex. On highly important issues, such as the adoption of the EU fundamental law (the Maastricht Treaty and Single European Act), enlargement and fiscal questions, the

[12] See Table 5. Voting shares in an Enlarged EU.

Council operates on the principle of unanimity[13]. This principle gives a great deal of power to all countries. Essentially it puts every country in a position to ruin the deal. Accordingly, important issues are packaged with other issues and this package of deals is expanded until everyone is satisfied with it. Many other issues are decided on the basis of 71 % majority rule[14]. In these issues, a winning coalition does not have to "buy off" all the opposition.

At this point, we shall introduce the main idea of the so called lobbying model. The model assumes that the political leadership behaves so as to maximize its chances of remaining in office. In a political market, the demand side includes lobbies either to favour or to oppose the adoption of a particular policy and the supply side consistes of governmental bodies seeking political support.

Accordingly, voting blocs are formed and can involve a struggle between two or more coalitions. These coalitions support a particular policy and under these circumstances political power is constituted by the ability of a country to turn a losing coalition into a winning one. For instance, on certain issues, the Eastern nations joining the EU will most likely have common views. If they are accepted while still being poorer than the average, they are likely to be greatly in favour of more structural spending. They are also likely to favour a strong common EU defence. Furthermore, since a much larger share of their GDP comes from agriculture (at least at current levels of income), they are likely to want a change in the CAP.

Since even the richest Eastern countries are poorer than the poorest EU members, they may join the poor EU members in demanding higher transfers. In the past, higher spending in the poor EU regions has been paid for with a combination of increased revenue contributions and reforms of the CAP. Since many Eastern countries are also quite agricultural and produce the types of food products that are heavily subsidized by the CAP, one can suggest that the poor coalition together with the Eastern component would demand that increased transfers not cut CAP spending. Thus the only possible alternative would be higher contributions by rich countries. Naturally, the rich countries can always say no to such increases. If, however, the poor coalition delays all the measures that the rich countries want, taxpayers in the EU are likely to be asked to pay more. This, in turn, suggests that the rich EU members might fear considerable Eastern enlargement. Naturally, it cannot work both ways. In the event that an Eastern enlargement were to sufficiently strengthen the power of the poor EU countries, the poor countries might possibly support it. If this was to happen, an Eastern enlargement would certainly lead to higher taxes, and so richer EU nations might oppose it. In contrast, if an Eastern enlargement were to have only a minor effect on the power of the poor coalition, the poor EU countries might oppose membership for the East European countries.

Analysis of the voting effects of an Eastern EU enlargement cannot focus only on the entrants. Typically, when new members are added, the power of existing members will change. If we add more countries without changing the number of votes per member nation, the power of the members will decrease. In other words, the more members there are, the less likely that one country's votes would be critical.

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[13] **Euroopan Unionin Jäsenyys.** Eurooppa Tiedotus 146/1994, Ministery of Foreign Affairs in Finland.

[14] Aro, P. - Kemppinen, R. (1993) **Euroopan Yhteisö.** Perusteos. Ministry of Foreign Affairs in Finland, Helsinki.

As with all the discussion in this section, speculation and supposition seem to be unavoidable. Nevertheless, the voting implications of an enlargement to the EU to the East are likely to be momentous. To maintain the momentum of European integration, the EU's Council of Ministers must be able to take difficult decisions. Moreover, there is a certain limit to how far the EU's financial resources can be extended and structural spending increased to encourage cooperation.

One of the main problems with the current voting system is the over-representation of EU citizens that happen to live in small countries. This problem must be solved. Integration towards the East would make a solution much more important.

The nature of the necessary institutional reform will be strongly influenced by the speed and extent of further integration. Naturally, the power of small countries has to be reorganized. Furthermore, the combination of poor versus rich is an important factor that has prevented the EU from decision-making. Thus it would seem that the faster this enlargement occurs, the stricter the reform of the voting process. All in all, any effort to predict the voting effects of an Eastern enlargement should be approached with caution.

3.6 Migration

Full membership of the Union would involve the free mobility of labour. This raises the possibility of large-scale East-west migration. This, in turn, could be another obstacle to the admission of the Eastern countries into EU within the very near future.

The migration pressures created by income differences of this magnitude are impossible to estimate with any accuracy. The determinants of international migration involve cultural, social, legal, environmental and economic factors, and all on a forward-looking rather than a historical basis.

Considering the earlier experience, it is possible to identify some of the factors that might influence migration patterns. For instance, high unemployment and expectations of it appear to be a major factor in internal and international migration in Europe. Youth unemployment in particular tends to stimulate outflows because young workers have fewer ties and hence face lower adjustment costs. This suggests that rapid population growth could increase rates of outflow.

The pressure of a large and underemployed agricultural labour force also raises the pressure for outward migration. The outflow would be caused not so much by emigrating agricultural workers but by pressure on low-skill labour markets in general. The migratory effect generated by Eastern agriculture might depend on how much output can expand to provide employment for the existing labour force. This in turn depends to some extent on EU trade policy. The timing of the pressure also depends on the progress of land reforms. UNECE (1992) argues that where agriculture is being decollectivized, the new peasant farmers will tend to remain in the sector for at least few more years[15]. Eventually, however, a large shake-out will be required to reach adequate productivity levels.

A potential difficulty for countries in the East is the nature of migration. Much of the available evidence suggests that it is the relatively highly educated who are the

[15] **Economic Survey of Europe in 1991-1992.** (1992) UN Economic Commission for Europe, New York.

most mobile. This raises the "brain drain" issue. This effect is based on the familiar concept that the East is relatively rich in (skilled) labour and relatively poor in capital. The great amount of skilled labour that is cheap by West European standards is one main of the attractions to foreign investors. However, if the Eastern countries joined the EU, all these skilled labourers would have the right to move to any country in the European Union. As a result of this situation, it could happen that the best from the East would move to the West. This type of migration would tend to equalize wages of comparable labour and reduce the incentives for Western investment in the East. Thus, the usual harmful effects of the "brain drain" on the East would be noticed in reduced foreign investments.

One interesting effect of East-West migration, which is often ignored, is its impact on the age profile and dependency ratios in Europe. The "dependency ratio" is defined as the ratio of the non-working-age and working- age populations. In general, these dependency ratios are lower in Eastern Europe than in the West. Moreover, there are some estimates that in West Europe this dependency ratio will rise steeply in the coming decades[16]. This ageing of the population is crucial here. Reducing the taxable proportion of the population is likely to cause various social and political problems. Now, the East-West difference in dependency ratios suggests an interesting possibility. As discussed earlier, EU enlargement would allow free migration, and migrants tend to be young. Thus, East-west migration might help with the problems caused by Western Europe's rising dependency ratio. In other words, young Eastern migrants could help to pay for the retirement benefits of Western Europe's ageing population.

The final focus on migration effects connects trade and migration. It is understandable that short-run EU policies greatly influence expectations and the future development of the Eastern European economies. Positive expectations may be self-fulfilling by causing relatively little labour outflow and a rising return on capital inflows. This would mean raising capital inflows and justified expectations. Negative expectations could create the reverse effects. If production becomes reoriented to the pattern suggested by the comparative advantage, it could maximize the employment effects of a given scale of capital inflow and also narrow the wage gap between East and West. The following equation illustrates the potential effect of trade on labour demand. The labour demand created by trade (imports and exports) depends on the share of labour in import and export-competing industries, the share of trade in GDP and the share of labour income:

Proportion of employment due to trade =

(share of labour in value added in export industry) -
(share of labour in value added in import industry) x
share of trade in GDP) / (share of labour in GDP).

The share of labour in value added varies widely across industries. However, if the East European trade is governed by comparative advantage we might expect the wage share to be higher in export industries than in import industries.

[16] Richard Baldwin (1994) **Towards an Integrated Europe.** CEPR, London.

The speed with which production can be reoriented towards comparative advantage will depend on capital inflows. It is likely that an important part of any capital inflow to the East will be related to export production. Two observations follow: first, the volume of investment is likely to be greater the more open the access to EU markets, the more secure this access and the more fully the Eastern countries are integrated with the internal market of the EU. Second, the composition of exports and hence production, determine the employment effects of a given volume of foreign investment. Finally, different sectors imply different capital/labour ratios.

In summary, the EU's trade policy will most likely have a direct influence on Eastern economies, especially through its effect on factor demands. If this trade does not develop, or if there are barriers imposed to the export of labour-intensive products, there may be no effect at all on labour demand. But if trade between the EU and the Eastern countries does realize its potential, and if this is also comparative advantage trade, one may expect it to increase demand for labour. Keeping in mind the fact that around half of the labour force in Eastern Europe is working in non-tradable activities (government, retailing), it is obvious that liberal trade could induce a significant increase in labour demand. But, to guarantee this effect, the East European countries must be able to specialize according to comparative advantage. The more secure this is, the more likely are rapid capital inflows and the consequent growth in labour demand. Thus, incentives to migrate will decline.

We have now analyzed both the main driving forces behind further integration towards the East and also the factors that are slowing the process. The main emphasis has been on economic gains and increased political stability versus the high budgetary costs and insecure migration effects resulting from increased integration. An enlargement of the European Union to the East is inevitable, but its timing, scope and outcome are still uncertain. Building a proper scenario for future development of the integration process is an extremely difficult task because there is so much uncertainty and so many unknown factors.

4 Achieving an integrated Europe – visions and realism

4.1 Overview

As discussed earlier, the club theory argues that if one takes a long-run view, integration of Eastern economies will require economic and institutional adjustment in both parts of Europe. This is really an argument for long run transition periods in the case of membership rather than an argument against membership. Given that, what are the visions and realism regarding integration of Eastern Europe with the European Union? The visions lie in the substantial potential for increased trade and in the political equilibrium both in the Eastern and Western Europe. The realism can be found in the reports and in the literature which say that it may take another ten, fifteen or twenty years before the Eastern European countries are likely to join the Union. Some of the countries in the East of Europe will never become full members of the European Union. Instead of waiting for a "miracle" to happen it could be more rewarding to deal with the question of what arrangements might be suitable in the meantime. Since the European integration process will imply adjustments and structural problems, we will need policies to cope with them. There are big gains to be had, but we also need policies to compensate some of those who are not gaining.

4.2 Three uneven steps to EU membership

It has taken over 30 years for present EU nations to reach their current degree of integration. Many different stages have been involved: the Common Market, the Single European Act and the Treaty on European Union. These three steps together form one large step, EU membership. So far, no new EU entrant has ever taken as large a step as that currently faced by all Eastern countries.

To demonstrate this, we shall present the major stages of economic integration in more detail. This will give an approximate idea, a vision, of how much work the process of integration and EU-membership itself requires.

As Figure 3 shows, the first step is identified as GATT membership and the second step is duty-free trade in industrial goods. The third step consists of sub-steps one, two and three. The first sub-step is the Treaty of Rome (1958)[17]; free trade was extended to all products and labour mobility was considerably expanded. Also, free trade in agricultural goods and the common agricultural policy (CAP) was included. Furthermore, it brought along a common external tariff and supranational institutions with real power. The most important of these institutions are the Council of Ministers, the EU Commission and the European Court of Justice.

Sub-step two is the 1992 Single Market programme (formally called the Single European Act). This programme reinforced the free movement of labour and goods. It also secured the free movement of capital and services. It guaranteed the right for EU firms to establish firms in all EU countries. The 1992 programme also included mutual recognition of health and safety standards, substantially harmonization of valueaddedtaxes (VAT), common certification procedures and strengthened control

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[17] Molle, Willem (1990) **The Economics of European Integration, Theory, Practice, Policy.** Dartmouth Publishing Company, England.

of competition policy and national subsidies. Finally, Structural Fund spending was doubled and majority voting was introduced in many issues in the Council of Ministers.

It should be stressed that the 1992 programme was very radical. In fact, the changes needed to implement the Single European Act have been so radical that some of the EU countries are still passing the legislation that was supposed to have been in place at the end of 1992. EU business is still in the process of adjusting to the new practices and laws.

The last sub-step, number three, is the Treaty of European Union signed in and named after Maastricht. On the economic side, Maastricht calls for a monetary union and a single currency. On the political side, it includes common security and defence policies, leading perhaps to a common defence. The power of the European Parliament is increased and EU citizenship is created. Most of this has been agreed, but is still to be implemented. All in all, Maastricht is playing an important role in the current restructuring of trade arrangements in Europe.

As seen in Figure 3, Eastern nations will face three steps towards closer integration. Theoretically speaking the first two are possible, or even relatively easy. The third step EU membership will be extremely difficult and perhaps impossible.

4.3 Interim policies

What are the policy actions that could be taken and by whom in order to promote this East-west integration process? At the beginning of this paper we argued that the integration of Eastern economies with the EU would require economic and institutional adjustment in both parts of Europe. After analyzing the concrete costs and benefits involved in the integration process, the answer seemed clear. It was also mentioned that Easterners would probably bear the brunt of integration. Much depends upon their transformation process, their progress in democratic and market reforms and their ability to establish political and economical relations with the West. The West can do little to help the East in its struggle towards a market economy and full membership of the Union. However, building a sensible path towards Pan-European integration was the one way Western Europe i.e. the EU could help. If so, what then is the role of the Union? The Union faces two kinds of incentives in taking up a major role in the formation of the "new club": "leadership incentives" and "bureaucratic incentives". The Union has responded to this challenge by providing support in three critical areas: aid, trade and association.

In aid, the target of the Union has focused on providing support towards the creation of a favourable business climate for investment and on helping in the development of a regulatory framework compatible with that of the Union. For this objective the PHARE (Partnership and Institutional Building Programme) aid programme was organized[18]. While the major funding was provided by member states, the Union designed and implemented assistance programmes in the areas of technology and science, industrial cooperation, telecommunications, and export credit and insurance. In addition, another aid programme, TACIS (Technical

[18] PHARE Partnership and Institutional Building Programme, signed 1993. The aid programmme was provided by the EU and it focused on the following target countries: Albania, the three Baltic states, Bulgaria, Poland, Romania, Slovenia, the Czech Rebuplic, Slovakia and Hungary.

Assistance to the Commonwealth of Independent States), was introduced soon after the PHARE programme . This aid was directed to Russia and to other former Soviet states.

In the area of trade, there have first been sectoral agreements and special arrangements in the form of quantitative restrictions on imports, and, secondly, sectoral agreements on agricultural products, steel and textiles. Since the Paris meeting of 1989 these measures have been compensated by the following arrangement; an acceleration of the timetable for the removal of import restrictions, the suspension of import restrictions on a number of sensitive products, the extension of the Generalized System of Preferences to the countries in the East of Europe and an improvement of access for agricultural products, steel, textiles and clothing[19].

The concept of association prepared in the Rome Treaty was elaborated in 1990 to promote closer cooperation with Central and Eastern European countries. This concept is mainly political and its basic objective is to prepare the way to full membership[20].

In terms of the framework discussed above, "aid" and "trade" can be considered as "benefit increasing" , by making the transition process faster and easier. The third measure, "association", can be thought of as "cost decreasing" since it lowers costs as it frees decision making and the negotiation costs within the club.

The Union has responded to a "leadership incentive" by increasing its role in international relations. This policy has had its effects that can be seen in areas such as monetary integration, trade policy and trade negotiations within the GATT and the Single Market Programme. Moreover, the Union has an incentive to strengthen its role through the transfer of sovereignty from member states and by creating new areas of competence, such as defence and security.

Another motivation for the Union to carry a leading role stems from the "bureaucratic incentive". The bureaucratic incentives to enlarge the club can be noticed as prolongation of the processes the Union is undergoing in the completion of the SMP. It has been argued that the SMP will strengthen the role of Union bureaucracy, in some cases at the expense of national bureaucracies. The main reason for this comes from the process towards uniform standards and rules in the EU. These common standards and rules require complex monitoring and control mechanisms. While waiting for the definition of real "unity" standards and regulations, the principle of mutual recognition will, on the one hand, shift responsibility towards the Union, and, on the other hand, increase the pressure from national interest groups to protect their current regulatory frameworks.

In addition, the majority rule (the opposite of the unanimity rule) has made it possible for the Union to overrule national preferences, thus strengthening the role of its officials in actual policy-making.

To summarize, there are both political and bureaucratic incentives to lower the costs on the part of the Union in this framework. This is because the increase in decision-making power for the Union goes hand in hand with the adoption of simpler decision rules.

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[19] Pelkmans J. - Murphy A. (1990) **Catapulted into leadership: the Community's trade and aid policies vis-a-vis Eastern Europe.** Journal of European Integration, special issue.

[20] Luca De Benedictis - Pier Carlo Padoan (1991) **The integration of Eastern Europe into the E.C., A Club Theory - Interest Groups Approach.** Centro Interdipartimentale di Economia Internazionale, Universita di Roma, "La Sapienza", CIDEI, Roma.

Despite the strong incentives the Union faces, its role in initiating virtuous circle and establishing the "new union" may not be sufficient. The Union is not (yet?) a fully supranational institution. It lacks both the power to enforce the dramatic policy changes necessary to achieve all targets in all areas and the financial resources to sustain them. For the new Union to develop, national governments must be directly involved both in mobilizing resources towards this target and in engineering the necessary policy changes within the Union itself.

The existing trade arrangements between Central and Eastern European countries, Russia and the other newly independent states, are, for the time being mainly bilateral trade arrangements; negotiated one-by-one and tailored with the EU. These agreements indeed build a flexible and dynamic framework for various forms of cooperation.

From the perspective of the newly independent states, the Union's prime objective is to maintain the stability of the region and increase both economic cooperation and "regular dialogue". According to the Commission's analysis progress and stability in the region can best be achieved through the evolution of democratic institutions, the reduction of the scope for conflict and the continuing promotion of economic reform.

As an example of the Union's efforts several actions can be mentioned. First, the Union has signed PCAs with Russia, Ukraine, Moldova, Belarus, Kasakstan and Kyrgystan. It is also working on further relationships with the other newly independent states. There is, for example, an agreement for a food aid programme for Armenia, Georgia, Azerbaijan, Kyrgystan and Tadjikistan for the winter 1995/96. The programme provides free agricultural products, technical assistance and humanitarian aid for the most disadvantaged and vulnerable sections of society. All in all, the European Union has used over ECU 0.5 billion annually since 1991 to fund Western experts to help Russia and its former Soviet neighbours privatize their industries, repair and run their nuclear power stations safely, reorganize ports (Odessa, St. Petersburg, etc.), distribute food more efficiently and modernize Russia's air traffic control, as well as encouraging Russian and European businesses to form joint ventures and invest in each other's countries. All this funding, administered through the EU's programme of technical assistance for the Commonwealth of Independent States, or TACIS, may seem to be a drop in the ocean, but it is a start.

However, the further development of the EU's relations with some of the newly independent countries is complicated by the ethnic turmoil and territorial conflict. The Union's medium-term aim for the all the former Soviet republics is therefore to negotiate separately tailored agreements for each, while advising them and assisting their development. Finally, since many of the newly independent states and Russia depend on one another for their economic well-being, it is strategically important to the EU to help them maintain their friendship.

The path ahead for the rest of Eastern Europe is more clear. The institutional structure of the EU provides an opportunity to bring the Eastern European countries gradually into the mainstream of the West European affairs. The European Council meeting of Copenhagen in June 1993 agreed that the associated countries in Central and Eastern Europe that so desire shall become members of the European Union[21]. Accession will take place as soon as the associated country is able to assume the

[21] **Europe Documents.**(1994) Europe Agence Internationale D'information Pour La Presse, No.1916, Bruxelles.

obligations of membership by satisfying the economic and political conditions required as set out in the conclusions of that meeting. The associated countries need to prepare for membership and to strengthen their capacity to assume the responsibilities of a member state. The main instruments of this strategy already exist; the goal of this so called **White Paper**[22] is to provide a route plan for the associated countries as they prepare for accession. The essential element of the White Paper is the countries' progressive preparation for **integration with the internal market** of the European Union, through the phased adoption of the Union's internal market characteristics. It will assists the associated countries to take on the obligations of membership of the Union and to develop their capacity to cope with competitive pressure and market forces within the Union. In the coming years, integration with the Internal Market will involve a complex process of approximation of legislation, norms, standards and institutions. The strategy today is therefore designed for the medium term but is accompanied by short term measures which will have immediate application. The short term measures include, for example, commercial defence instruments, improved access to the Union's market in the area of textiles, cumulation of rules of origin and adjustment of the Association Agreements. The medium-term measures include the associated countries' need to align their legislation with that of the Union. They will have to put into place legislative and regulatory systems, standards and certification methods compatible with those of the EU. Furthermore, the medium-term measures also include a satisfactory implementation of competition policy and control of state aid together with the application of that part of Community law linked to the internal market.

Also, the agricultural sector and the related food-processing industry in the associated countries contribute significantly to the economic development of these countries. The Commission will therefore examine the effects of all subsidized exports on agriculture in these countries. The Commission will conduct this examination in the light of the respective price levels in the EU and in the associated countries and will take account of these differences in setting refunds.

Rapid growth and continuing structural reform in the associated countries are essential elements for the eventual success of the process of economic transformation. While increasing savings will finance domestic investments, foreign investment is also needed at a much greater level. Therefore the EU has adopted a programme to stimulate investment from the Union.

Finally, the strategy of integration with the internal market will be supported by the implementation of policies to promote integration through the development of infrastructure, cooperation in the framework of trans-European networks, promotion of intra-regional cooperation, environmental cooperation, and cooperation in culture, education and training. Politically the strategy will be realised through the development of a structured relationship between the associated countries and the Union.

It is apparent that if we add all factors involved with the integration process, there will be no shortage of visions concerning policies in the meantime. But the most interesting question is whether these visions are correct and realistic.

[22] **Euro East.** Monthly No.33, May 18, 1995.

4.4 Remarks and conclusions

In this article we have studied the integration of countries in the Eastern Europe with the European Union, mainly following the club theory approach. We have argued that the inclusion of the Eastern nations into the EU can be described as a process of setting up a completely new club with respect to the present EU structure. Both economic and institutional adjustment will be needed in both parts of Europe. The current situation is such that immediate EU membership for the Eastern European countries is impossible. There is the adjustment problem indicating that for the time being, inclusion of these countries into the European Union would generate more costs than benefits. To start the process leading to complete integration the club size, marginal costs and marginal benefits need to reach the point, at which the marginal benefits exceed the marginal costs due to increased market liberalization and the increased number of members. How far will be possible to continue this integration process? The club theory offers a simple, but convenient answer: Integration will continue and the European Union will expand as long as the marginal benefits generated exceed the marginal costs. Once they are equal, the Union will have reached its optimal size.

On the benefit side there are political and economic aspects. EU membership would provide Eastern countries with a safeguard against the internal opponents of democracy and capitalism. For the West, it would mean the security and political equilibrium provided by a better ability to follow and be part of development in Eastern countries. Furthermore, large economic gains from free trade would benefit both parties. Thanks to free trade, countries would be able to allocate their resources and productive factors efficiently by following the true comparative advantage.

Since the Eastern countries are relatively poor, populous and agricultural, their membership also involves a large amount of cost and risk. The EU budget would expand drastically. With only the Visegrad countries, the EU's budget would grow by two thirds. Full membership of the Union could also cause large-scale East–west migration. High unemployment, wage differentials and youth unemployment would stimulate outflows from the East. On the other hand, increased productivity and economic growth could also increase labour demand, which would tend to bring wages in East and West closer together and no migration would occur. The unpredictable nature of migration creates fear and can become a cost-increasing factor. Finally, the possible membership of the Eastern countries would also require reorganization of the current voting system.

It took over 30 years for the present EU nations to reach their current degree of integration. This obviously raises the issue of visions and realism of the integration of Eastern Europe into the EU. There are three uneven steps to be achieved. The first two, GATT membership and a Bilateral Free Trade Area, are easy. The third step, or actually "leap", leads to full membership of the Union. The Eastern countries will obviously face difficulties in reaching this third step. It is most likely to take decades, or for some countries, to be impossible. However, in the long run, if the political situation in the East is stable and the transition process goes smoothly, many or at least some of the Eastern countries could become members of the European Union. Thus, the club theory argument is rather an argument for long run transition periods in the case of membership rather than an argument against membership.

East–west integration requires both economic and institutional adjustment in both parts of Europe. Most of the pain, however will be suffered by Easterners. They must succeed in their transformation process and their democratic and market reforms. The West can only provide aid within its financial limits.

It is impossible to foresee the future - perhaps that is why constructing scenarios, visions of the possible order of things in the future, is important. While doing so, Europe needs to know where it is going and how to reach its chosen destination. Europe needs to know how to get where it is going and what to do in the meantime. There can be no single best response to such questions. The future depends upon so many unknown factors. Perhaps the most one can hope for is to ask the right questions and by thus to choose the correct course of action. If the club building process gathers enough momentum, then the benefits deriving from it would eventually affect and feed back on the obstacles. In that case it would be easier to say "welcome to the club!".

Figure 1. **Marginal Costs and Marginal Benefits**[23]

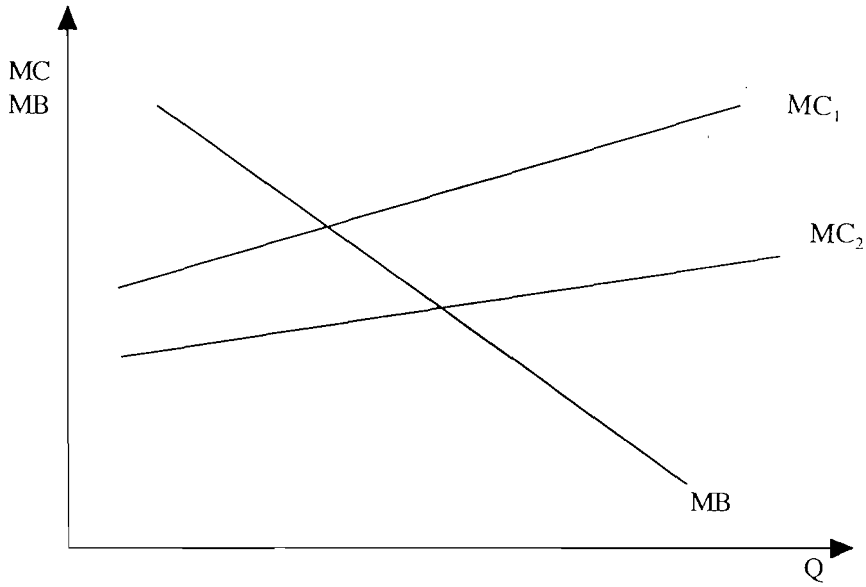
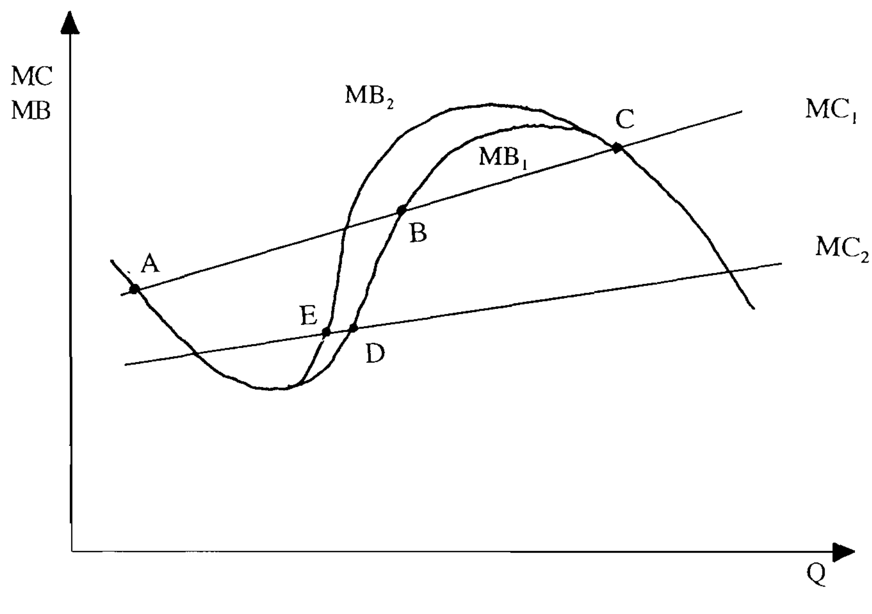


Figure 2. **Opportunities and Costs of Further Integration**



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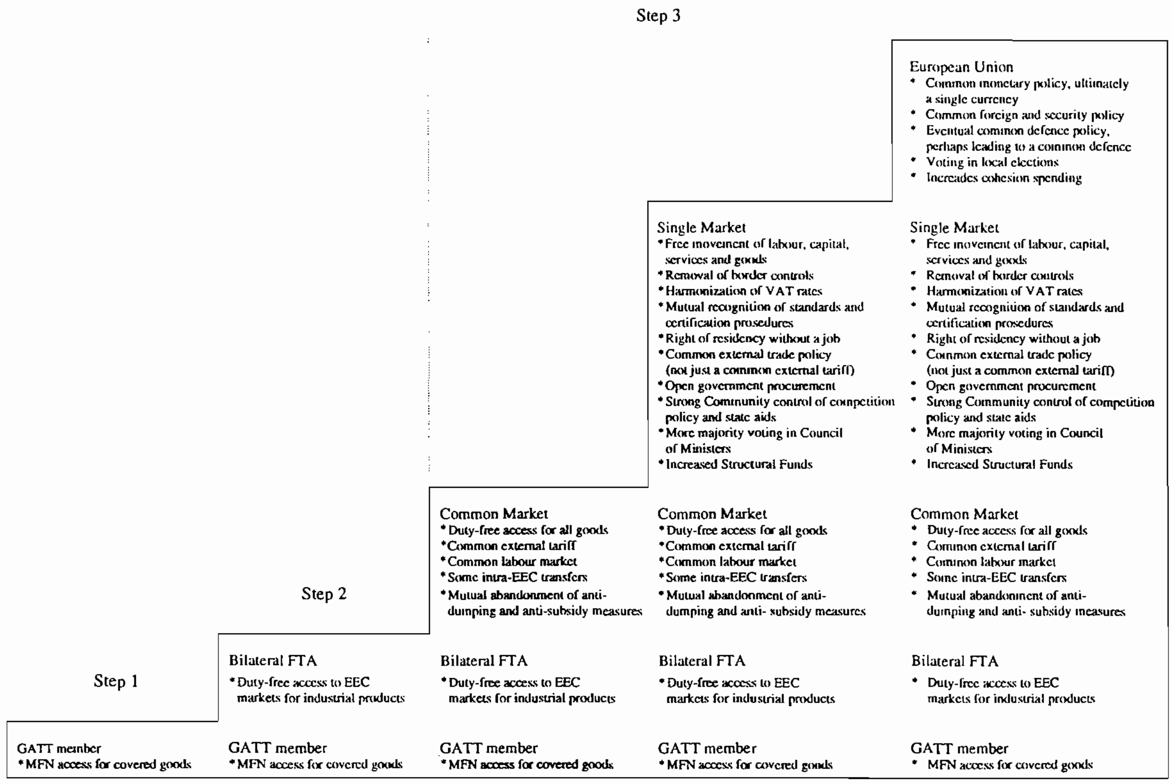
[23] Figures 1 and 2: Luca De Benedictis - Pier Carlo Padoan (1991) **CIDEI Working Paper.** Centro Interdipartimentale di Economia Internazionale Universita di Roma, "La Sapienza".

Figure 3. **Three Steps to EU membership**[24]



[24] Baldwin, Richard (1994) **Towards an Integrated Europe.** CEPR London.

Table 4. **Per Capita Income Levels**[25]

	GNP per capita in $, 1992
EU 11[1] Ø	26.559
Greece	7.290
Ireland	12.210
Portugal	7.450
Spain	13.970
Poor EUs Ø	11.755
Czech Rep.	2.450
Hungary	2.970
Poland	1.910
Slovakia	1.930
Slovenia	6.540
V4 + Slovenia Ø	2.299
Estonia	2.760
Latvia	1.930
Lithuania	1.310
Baltics Ø	1.806
Bulgaria	1.330
Croatia	1.685
FYR Mac.	1.685
Romania	1.130
Southern Group[2] Ø	1.276
Belarus	2.930
Moldova	1.300
Russia	2.510
Ukraine	1.820
European CIS Ø	2.339

[25] Bofinger, Peter (1995) **The Political Economy of the Eastern Enlargement of the EU.** CEPR Discussion Papers No.1234, London.

Table 5. **Voting Shares in an Enlarged EU**[26]

	Percentage votes in EU 15	Percentage votes in EU 20	Percentage votes in EU 23	Percentage votes in EU 28	Percentage votes in EU 32	Voting shares of a large country (Germany) in an enlarged EU	Memorandum item population shares of Germany
EU 12	87,4	68,5	63,3	54,3	42,7	13,2	23,2
Austria	4,6						
Finland	3,5						
Sweden	4,6						
EU 15	100,0	78,4	72,5	62,2	48,9	11,5	21,8
Czech Republic		4,5					
Hungary		4,5					
Poland		7,2					
Slovakia		2,7					
Slovenia		2,7					
EU 20		100,0	92,5	79,3	62,4	9,0	18,5
Estonia			2,5				
Latvia			2,5				
Lithuania			2,5				
EU 23			100,0	85,7	67,4	8,3	18,2
Albania				2,1			
Bulgaria				2,9			
Croatia				2,1			
FYR Macedonia				2,1			
Romania				5,0			
EU 28				100,0	78,7	7,1	16,6
Belarus					2,8		
Moldova					1,7		
Russia					11,2		
Ukraine					5,6		
EU 32					100,0	5,6	11,5

[26] Bofinger, Peter (1995) **The Political Economy of the Eastern Enlargement of the EU.** CEPR Discussion Papers No.1234, London.

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