Eastern Enlargement as an All European Development Project

Editor
Wolfgang Blaas

Conference Reader
Conference of the Thematic Network
Improvement of economic policy co-ordination for full employment and social cohesion in Europe
Budapest, 7-9 March 2003
Contents

Preface
Introduction: The All European Development Project
  Economic Policy Challenges of Enlargement (J. Huffschmid)

Part 1: The Dynamics of Eastern Enlargement
  Eastern Enlargement and Convergence in the EU (T. Morva)
  EU Monetary Union and Enlargement (C. Thomasberger)
  Enlargement and structural changes (G. Dahlström)
  Enlargement and cohesion - a Reform of Objectives and Funds
    (H. Bömer, A. Borchart, W. Schlegel)

Part 2: Country specific Issues of Enlargement
  Accession to EU - yesterday, today, tomorrow (T. Kowalik)
  Economic and social development in Slovakia after 1989 and accession
    to the EU: Development trends and transformation cycles (I. Okáli, M. Šikula)
  Slovenia: Alternative Economic Policies in Action (J. Mencinger)
  The accession of the GDR to the Federal Republic - the first step to
    eastward expansion of the EU? (K. Steinitz)
  The Hungarian way to the European Union (L. Andor)

Part 3: The Emerging Model of European Capitalism in the Global Context
  What kind of Europe do we want? (K. Lóránt)
  Liberal models of European construction (C. Samary)
  Trying to catch up: the transformation countries and the treacherous
    playing fields of the global market (E. Matzner)
  What is the American model really about? (J. Galbraith)

Abbreviations
About the Authors

Gedruckt mit Förderung des Bundesministeriums für Bildung, Wissenschaft und Kultur

28. Jahrgang
Heft 3-4/2002, Februar 2003

Preis:

<table>
<thead>
<tr>
<th></th>
<th>Inland</th>
<th>Ausland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Einzelnummer</td>
<td>€ 5,10</td>
<td>€ 5,80</td>
</tr>
<tr>
<td>Doppelnummer</td>
<td>€ 9,50</td>
<td>€ 10,90</td>
</tr>
<tr>
<td>Jahres-Abo</td>
<td>€ 16,00</td>
<td>€ 18,20</td>
</tr>
</tbody>
</table>

PSK-Konto-Nr. 2.415.150
(Österreichische Postsparkasse)
Preface

This Conference Reader has been published in preparation of the conference *The All European Development Project* in Budapest, March 2003.

The conference is part of the agenda of the EU-supported thematic network *Improvement of Economic Policy Coordination for Full Employment and Cohesion in Europe*.

Whereas the overall objective of the network is to propose improvements of European economic policy co-ordination which contribute to the achievement of full employment and stronger social cohesion in an enlarged European Union, the conference focuses on particular issues of EU enlargement.

The contributions in this reader reflect this focus. In the first part *The Dynamics of Eastern Enlargement* are being discussed from a number of different perspectives, including the issues of convergence, monetary integration, structural changes and cohesion.

In the second part *Country specific Issues of Enlargement* are dealt with from the point of view of some of the accession countries, namely Poland, Slovakia, Slovenia and Hungary. Furthermore, a comparison of the integration of the German Democratic Republic into the Federal Republic of Germany with the transition and accession processes in other central and eastern European economies is given.

*The emerging model of European capitalism in the global context* is the topic of the third part of the reader, where questions are raised and elaborated which concern the vision of the European variant of capitalism. In order to contrast continental European developments with the anglo-saxon model, an account of the American kind of market capitalism is also presented.

From an editorial point of view a disclaimer seems to be appropriate. The time span between the arrival of papers and publishing them was so short that a feedback from the authors (proof reading phase) was not possible. Therefore only marginal editorial and layout improvements could be made.

Nevertheless I would like to think that this reader will be an important source of information and knowledge about enlargement issues. The expertise of the authors contributing to this volume may be an assurance for a high quality.

Wolfgang Blaas
Vienna University of Technology
February 2003
Introduction:
The All European Development Project

Economic Policy Challenges of Enlargement

J. Huffschmid
1. All European development strategy vs. club approach

The approach followed by the European Commission and Council in the negotiations with the central and eastern European countries (CEEC) has been based on the conception that the latter should become like the former: They should become stable democracies with strong and efficiently functioning market economies and they should take over the "acquis communautaire", i.e. all regulations currently in force in the current EU of 15 members (EU15). This is the essence of the three pillar strategy adopted in Copenhagen in 1993 and it is the basic content of the 31 chapters negotiated with the applicant countries during the last years. After the collapse of the political and social institutions in the CEEC the reconstruction should emulate the pattern of the EU countries. Following this guideline they would receive political and some financial support from the EU15 and finally they would be admitted to the EU like individuals are admitted to a tennis club.

This approach is based on two assumptions which are at least very problematic:

The first implicit assumption - and often the explicit claim -, that the EU has a genuine democratic basis and a strong economy with appropriate rules and institutions, and that therefore it needs no basic changes, does not correspond to the "really existing" European Union. The EU economy is far from working satisfactorily. It has gone through a decade of slow growth with high unemployment, and the recovery after the latest recession is very weak and on the brink of a new downturn. Unemployment, inequality and social exclusion are much higher at the beginning of the present than the last decade. The introduction of the Euro in 1999 has been followed by a weak performance of the new currency, and the worldwide stock market crash has been more marked in the EU than in the USA. There are also some dark spots on the picture of the thoroughly democratic character of the EU. The European Parliament (EP) is very insufficiently involved in the legislative process, and democratic accountability in such basic areas like monetary policy is inexistent. The procedure of the Council is opaque for the public and decisions often appear as imposed coercions for the populations - which they sometimes in fact are. Therefore it can be no surprise (but should be a matter of concern) that the EU is regarded by many as something beyond the interest of common people. This is reflected in the low and falling participation in the elections for the EP and also in the increase of openly nationalist currents in the EU.

None of this can serve as argument against accession. After the collapse of the attempts to establish socialist societies in eastern Europe the accession of the EU is a stabilizing perspective for most countries, preventing increasingly sharp conflicts which could escalate into military and paramilitary aggressions within and between countries as it was the case in former Yugoslavia. Also the economic and social situation and outlook in the EU are in spite of all problems obviously better than in the CEEC. Accession is therefore an attractive perspective for the people and governments in these countries. For the EU15, too, it can be an attractive outlook, if the process of unification is handled properly. But how to do this is the decisive question.

The second flaw in the club approach is the underlying assumption that after enlargement the EU will be larger but not substantially different from the present EU15. It will be substantially different, even if the CEEC fulfil all the requirements set in the negotiations. The positive side of this is that the historical and cultural diversity will be considerably larger than that of the EU15, and this should be a matter of joy and satisfaction. The problematic side is that economic and social disparities will have deepened like they have never grown in any of the previous enlargements. The enormous differences in the living conditions of the population of the EU are the main political challenges in the decades to come. If European economic and social policy does not meet these challenges, disparities will grow and generate conflicts within the EU which may well undermine its political stability and in the last instance the existence of the union itself. The reduction of these differences will not be possible if the past and current economic and social policies are simply extended to the new members and applied to the larger EU. These policies were already insufficient for the EU15 and their extension in the EU25 will continue to impede economic and social progress and deepen the gaps within Europe. Thorough reorientations are necessary, and all members should participate in their elaboration and implementation.

One of these reorientations is the development of genuinely democratic and efficient political institu-
tions of the EU. The current work of the European Convention meets this requirement only very insufficiently, because the new members can participate in debates but not in subsequent decisions.

Other essential parts of the necessary reorientation in an all European development strategy relate to economic and social policies. They require the removal of the neoliberal bias, which has done much harm to the EU15 and to the CEEC alike. The working group “European economists for an alternative economic policy in Europe” has proposed a framework of main general objectives for a democratic and efficient economic policy working in the interests of the majority of people: full employment, social equity, social welfare and ecological sustainability (see European Economists 2002: section 2). The following sections will outline four of the key challenges for economic and social policy, which must be met to move the enlarged EU towards these goals: macroeconomic policy, structural policies, pension reform and financial market policy.

2. Breaking the macroeconomic blockade

We have recurrently criticised the macroeconomic policy arrangements in the EU15, which lead to a self-imposed blockade of growth and employment (see European Economists 2000, European Economists 2001). Monetary policy is assigned to the ECB with the very narrow mission of preserving price stability as highest priority and - different from the US Federal Reserve System - no concern for growth and employment. The definition of price stability and the assessment of whether it is endangered or not are removed from any democratic decision procedure and exclusively left to the ECB which can act in complete independence. The use which it has made of this independence has materialised in an excessively contractionary policy. Fiscal policy is largely left to the member states with no positive binding co-ordination rules. The only binding rule is negative: the strict constraint on public deficits laid down in the Treaty of Maastricht which has been reinforced by the Stability and Growth Pact (SGP) of 1997. The result has been an austerity prone policy in all member states throughout the 1990s, which brought the economies on a slow growth path and increased unemployment. However, the policies of strong cuts in public expenditures - mostly in the social policy area - did not prevent deficits to rise again in several member states beyond the limits set in the SGP. It has been demonstrated clearly that a schematic one-size-fits all rule is not only inefficient but counterproductive. The so-called macroeconomic dialogue which was adopted at the summit of Cologne in 1999 was a dead-born child, because it leaves no room for manoeuvre: Since the ECB and the fiscal authorities are bound by their statutory assignments and legal constraints, the whole responsibility for growth and employment is placed on the wage side, which has led to enormous pressure upon trade unions. The result was a rather drastic change in income distribution against wages, which led to stagnating private consumption.

The problems of slow growth and high unemployment will be much enhanced if the current badly conceived macroeconomic strategy is maintained after enlargement. The reason for this is the still very low level of income and - in most, not in all sectors - productivity in the new member countries. With an average per capita income level below half of that of the old EU15 (measured in PPP, see European Commission, 2002b: Annex 7, p.98) the disparities within the enlarged Community will considerably grow. The basic challenge is therefore to organise a strong and continuing catch-up process, which requires growth rates in the CEEC which are substantially and persistently higher than the ones in the EU15. Statistically this has been the case during the last few years, because growth in the latter stalled. But the unacceptable price for this is higher unemployment in the EU15. Therefore the catch-up process in the enlarged EU must be organised in a way that solid growth rates in the EU15 go along with higher growth in the CEEC. Macroeconomic policy which must provide the framework in which this can happen, is currently largely inappropriate, although the contractionary bias of monetary policy could be somewhat mitigated for the CEEC as long as they maintain their own currencies and operate in a kind of exchange rate mechanism, (the details of which seem not to have been worked out until now). The main obstacle for growth will remain the immediate subordination of the CEEC to the deficit limits of the SGP. This will further constrain the room for an expansionary economic policy. The preservation of the existing macroeconomic arrangements and orientation would exacerbate the unfortunate economic situation and development in the EU.

The macroeconomic reforms, which are required to manage positive growth and reach full employment in an enlarged EU relate to monetary policy, fiscal policy, exchange rate policy and the setup of a framework for a tighter coordination between member states and policy areas. This coordination should go beyond macroeconomic policy and also encom-
The basic principles of monetary policy should be revised in a sense that monetary policy should have the task of providing the amount of money and credit which is necessary to support and promote the proper functioning of the economy in the sense of full employment, reasonable price stability and steady sustainable growth. This would also include the role of the Central Bank as a lender of last resort. On this basis a differentiated policy of credit provision is possible, including for instance such instruments as differentiated reserve requirements for different countries within the EU.

The enlargement should be an occasion to abandon at last the SGP, which has been proved to be inapplicable anyway in cases of strong tensions, and which has done much harm in the five years during which it existed. But the SGP should not simply disappear, leaving it to the member states to do whatever they want. Instead a tight co-ordination process should be introduced on the European level. The institutional basis for this could be the introduction of a kind of Economic Government, consisting of member country representatives, Commission members from the departments for economic and financial affairs, employment and social affairs, ECB members, with EP- and ESC-members in a consultative capacity. Although the last decisions will until a complete revision of the European constitution towards full democracy remain with the member states, the co-ordination process should have strong binding elements. This is all the more achievable, if the policy recommendations which are given in such a process are transparent and beneficial for all and if they are supported by instruments and help for implementation. Agreement must be reached for a different treatment of different situations in the Union. On the basis of this understanding a macroeconomic stabilization fund should be established from which unbureaucratic transfers can be extended to countries whose macroeconomic situation deteriorates more rapidly than in others. This fund can be financed either directly through the EU budget or through special contributions of the member countries (for details see Schratzenstaller 2002). In the framework of such coordination the operative activity of the ECB remains the domain of its independent decisions while the fixing of the target rate of inflation and the assessment of the current situation should be embedded in the coordination process and the results emanating from these discussions should be binding guidelines for all actors including the Central Bank.

With regard to exchange rates the ERM 2 should remain (or become!) a flexible instrument of adjustment with the objective of preventing sudden disruptions, speculative flows and of supporting a step-wise catch-up process. Therefore the European fund for monetary co-operation should be revitalised.

### 3. Enhancing structural policies for social cohesion

As mentioned above the regional and social disparities - measured in per-capita income or unemployment rates - will become sharper in the new EU25 than they were in the EU15. At the same time it must be noted that in the EU15 gaps between rich and poor regions have not become smaller but distinctly larger during the last decade (see European Commission 2002a: Statistics A20). An economic development strategy in a large EU25 should take account of both facts. In reality the opposite is the case.

That the new round of enlargement takes place not only in a - in comparison to previous enlargements - very different economic and political situation but also under an almost completely opposite economic policy paradigm, is nowhere more obvious than in the approach to structural policies and cohesion. While the accession of Spain and Portugal in 1986 was accompanied by a doubling of structural funds within four years and a further doubling took place until the late 1990s, no further increase but a decrease is envisaged for the years to come.

Structural (and agricultural) policies with regard to enlargement are full of strange and inconsistent developments. In the spring of 1999 the EU15 adopted in Berlin an “interinstitutional agreement” as binding framework for the development of the EU budget until 2006. It defined a share of 1,27% of GDP of the EU as upper limit for expenditures - without bothering to give any reason for the choice of this figure. The expenditure should include “preaccession aid” and structural support for the new member countries (defined in the Agenda 2000, see European Commission 1999). At the time of this agreement the assumption was that the first round of enlargement would take place in 2002 with six countries (four CEEC). Subsequently this assumption had to be corrected twice: The first round of accession will take place in May 2004, and it will not comprise six but 10 countries. In spite of these far-reaching changes in the enlargement schedule no adjustments were made in the financial provisions. In January 2002 the Commission presented its new financial projections for the acceding countries, in which neither the amount saved in planned aid to newly acceded countries in 2002 and 2003 was shifted to the category of...
pre-accession aid, nor was the amount of post-accession aid adjusted to the higher number of acceding countries (in fact the doubling of the number of CEEC). On the contrary the numbers were corrected downwards. While in the Agenda 2000 it was envisaged to spend 42.59 bn. € for the three years from 2004 to 2006 for six new members, the Copenhagen summit of December 2002 set the maximum amount for enlargement-related appropriations for agriculture, structural actions, internal policies and administration at 37.57 bn. € (both in 1999 prices, see presidency conclusions 2002:11), which is a reduction of 11.8% in real terms. This smaller amount of aid will go to a larger number of countries - and it will partly be paid by these countries themselves.

With regard to agricultural policies the reorientation process in the EU15, which had gained some thrust with the 1992 reform has since been slowed down and has by now almost come to a standstill. The problem that the new members would under the existing regime of Common Agricultural Policy (CAP) be entitled to substantial subsidies, which would - the total extent of the budget remaining basically unchanged - lead to reductions in payments for farmers in the EU15 was solved at the expense of the new countries: Their subsidies will be reduced to 25% of what they would get if the rules were correctly applied, and this share will rise to 100% within the next 10 years. This will on the one hand reduce the pressure for agricultural reform in the old member countries, which is nevertheless very urgent. On the other hand it could lead to the situation that new members like Hungary which must from the beginning of their EU membership on contribute fully to the EU budget, will become net payers and thus be worse off than they had been before accession. To avoid this absurd outcome the EU decided in Copenhagen to pay a temporary lump-sum amount of 3.29 bn. € for the next three years to offset net budgetary losses for acceding countries (see ibid.:12). Even with this payment the total financial support for ten new EU members (40.86 bn. €) remains smaller than had been envisaged for six countries in the Agenda 2000 (42.59 bn. €)

At the same time current plans envisage that the overall budget of the EU will until 2006 grow only negligibly, so that the modest net financial support to the new member countries has partly to be financed through reduction - according to the Agenda 2000 from 29.4 bn. € to 26.7 bn. € - of funds for structural policies in the old EU, in which regional disparities have increased. This is not enhancing the support for accession from the side of the southern countries. Of course structural policy is not a matter of money alone. But without more money the sustained reduction of regional and social disparities in the enlarged EU is simply not possible. It is also not sustainable to mobilise the additional money for the CEEC by reducing resources for structural policies in the EU15, where regional disparities are increasing, too. An all European development strategy focusing on the improvement of regional and social cohesion in the EU25 must be based on a wider financial room for manoeuvre. This requires the removal of the limit of 1.27% of EU-GDP and a substantial increase in the European budget. That this evident requirement is blocked for mostly ideological reasons and against all sound economic arguments is a scandal. It raises the question whether the countries which stand in the way of this increase are really serious in their declared support for enlargement, or alternatively whether they really know what they are doing and which political and social costs increasing inequalities in Europe will generate in the future.

4. Preserving and restoring public pension systems

In some areas transformation of the old socialist societies has under the pressure of powerful neoliberal advisors gone beyond what is presently the case in the EU15. However, in the negotiations for accession such neoliberal over-shootings were not corrected with reference to the "acquis". Instead the EU is now using such reforms as spearheads to accelerate its neo-liberal agenda in the old EU. Perhaps the most telling example for this is the treatment of the social security systems, particularly pension systems. The ambition of the EU, very clearly expressed at the summit in Lisbon in March 2000, is the "modernisation" of the pension systems in the EU. Modernisation in this context means the shift from a mandatory public pay-as-you-go-system (PAYG) which is still the predominant system in the EU. Modernisation in this context means the shift from a mandatory public pay-as-you-go-system (PAYG) which is still the predominant system in most member countries to a private funded system, which depends essentially on the proper functioning of capital markets (see Etxezarreta 2002). Attempts to accomplish such shifts, which member countries must implement have been met with strong resistance in various countries, including a - largely successful - general strike in Greece. Furthermore the perspective for further privatisations of the pension systems have somewhat diminished with the collapse of the stock markets, which exposed the incalculable risk of capital funded pension systems to a large public.

In the CEEC the transformation of a public PAYG
system into a "mixed" system has in most cases already gone much further (see Müller 2001, Augusztinovics 1999), the only exceptions being Czech Republic and Slovenia. The particularity of the eastern European mixed systems is in most cases that they contain a strong bias for further change in favour of the private capital funded side and against the public PAYG side. They can therefore be seen as a decisive step towards full privatisation of pension systems. This change towards neo-liberalism in social security has taken place with active support (if not under strong pressure) of the IMF and particularly the World Bank which has in 1994 launched a worldwide campaign for fully privatised pension systems (see: World Bank 1994).

After enlargement a considerably larger part of the then 25 EU members will therefore have pension systems which are radically different from the traditional European (Bismarckian or Beveridgean) structure, both of which (in spite of their considerable and relevant differences) regard it as a responsibility of the whole society to prevent the emergence of poverty and to guarantee a decent standard of living to every member of the society. It will become more difficult to resist the campaign for further privatisation and subordination of the social welfare of the people to the risks and volatility of financial markets. On the other hand the recent stock market crash has demonstrated that such resistance is absolutely justified and vital for the safeguard of stable pension systems. Therefore enlargement may be an opportunity to combine the critical forces and to strengthen the opposition against further privatisation. There is a broad spectre of possibilities to maintain, modernise and strengthen public pension systems even under circumstances of ageing populations, ranging from making all kinds of income subject to social security contributions, passing by a more proactive employment policy including a more energetic policy for equal opportunities for men and women, to increases in the amount of social security contributions.

5. Financial market reforms in the public interest

Enlargement should also reinforce the critical re-examination and reorientation of the ongoing formation of a single European financial market, which follows essentially a deregulatory agenda. The imposition of this agenda upon the CEEC would be highly inappropriate with regard to the present weaknesses and vulnerability of the financial sectors in the CEEC. After ten years of transformation of a public monobank system into a two tier system with a public central bank and a second tier of mostly private commercial banks the financial sector in the CEEC is underdeveloped, bank-based and foreign controlled (see for the following Caviglia et al. 2002). The overall degree of financial intermediation is still low and the relative size of the financial sector (in comparison to GDP) is still a small fraction of that of the Euro area. Assets in the banking sector, which amount to 265% of GDP as an average in the Euro area, are highest (130%) in Czech Republic and lowest (30%) in Romania and Lithuania (p.18). Stock market capitalisation (72% of GDP at the end of 2001 in the Euro area, with an exceptionally low figure of 14% in Austria) was 30% for the highest (Slovenia) and below 5% for the lowest (Bulgaria and Romania) CEE countries. The bond market in general played only a limited and the corporate bond market a negligible role. The structure of corporate financing is mostly through internal resources and external finance is largely provided via bank loans. Banks are in turn mostly under foreign control: in all countries at least three of the five major banks are in full or dominant foreign ownership and altogether foreign banks control more than two thirds of financial institutions in the CEEC.

Which impact will enlargement have on the financial sector in the East? On the one hand one could expect that foreign ownership of major banks conveys a certain degree of stability to the sector since it opens a comparatively easily accessible window of foreign finance, which has been rather intensely used during the last years. On the other hand the dominant role of one foreign institution makes smaller countries very vulnerable and dependent from the performance and strategic policy of the dominant player. A crisis or a strategic reorientation of a large foreign bank can have consequences for a small country that are beyond political control. While crises due to external factors cannot be prevented by CEEC governments, they will probably be much under pressure to avoid the exit of a larger bank and therefore be prepared to far-reaching political concessions. Ongoing financial market reform in the EU 15 - as reflected in the Financial Services Action Plan of 1999, the Lamfalussy report of 2001 and the subsequent legislation - has been criticised by us, because it imitates without much reservation the American model the instability of which has been demonstrated recently and the social usefulness of which for the majority of the people can be questioned with good reasons (see John Grahl et al. 2002). Integration of the underdeveloped financial sector of the CEEC into this deregulatory environment could on the one hand
enhance the insufficient liquidity of the eastern countries and would insofar have positive effects. On the other hand the lack of a strong regulatory framework particularly in the securities sector would expose the CEEC markets to volatilities and risks which are beyond their control. This is all the more worrying because the expansion of the securities market is expected to become a result of the pension reform. "Pensions reform and rapid growth in the insurance market would, if done successfully, support the development of domestic institutional investors …" (Wagner/Iakova: 10) As long as strong rules for consumer protection and high minimum standards for securities issues and trading are not adopted across the union, the further opening up of financial markets remains a very risky business. Therefore enlargement makes it particularly urgent to speed up and reorientate the direction of financial market reform in the EU - and until a strong safety net has been established exceptions and transition periods should be introduced for the CEEC.

6. Conclusion

The deficits and damages of the current neo-liberal economic and social policies are becoming more evident every year - in the EU15 and in the acceding countries. Theoretical criticism and social opposition have been rising since several years. In most countries at some point during the last decade it has led to the replacement of openly conservative governments by moderate social democratic ones. Expectations and hopes connected with these changes have been largely disappointed, and this has in many cases - in the EU15 more than in CEEC - brought conservative parties back to government. But nevertheless the tide of social protest and mobilisation is mounting. The conception of a comprehensive joint European economic development strategy beyond neo-liberalism requires close conceptual cooperation between critical economists from the EU15 and the CEEC. This seems to be a challenge difficult to meet. Critical progressive economists in this sense are under strong pressure in the CEEC as well as in the EU15, and their influence on politics is equally negligible. There are of course critical individuals and probably critical networks everywhere. For the further development of what we have called an All European Development Strategy it is of great importance that these individuals and networks get in contact, strengthen their mutual communication, exchange experience, views and arguments and organise close cooperation. This can be counted as a further modest reason why enlargement, with all its problems and challenges, is a historical opportunity for all of us.

References


Presidency Conclusions, 2002, Presidency Conclusions, Copenhagen European Council 12 and 13 December 2002. SN 400/02


Part 1: The Dynamics of Eastern Enlargement

Eastern Enlargement and Convergence in the EU
   T. Morva

EU Monetary Union and Enlargement
   C. Thomasberger

Enlargement and structural changes
   G. Dahlström

Enlargement and cohesion - a Reform of Objectives and Funds
   H. Bömer, A. Borchardt, W. Schlegel
1. Introduction

Convergence is a basic principle and a cohesive force of the European Union. The eastern enlargement will put strong pressure upon the implementation of this principle since the difference in GDP per head level and the number of cohesion regions and countries will largely increase within the Union. Although the phenomenon is well known, the extent of the problem is rarely discussed and consequences are often underestimated. The precondition of the accession of the candidate countries was to adopt the Union’s values and provisions fully. The study raises the question, what kind of changes is needed in the economic policy of the Union in consequence of eastern enlargement.

In the early nineties the general opinion was that the eastern enlargement of the Union, similarly to previous accesses, will occur gradually. The Agenda 2000, the document prepared by the European Commission (July, 1997) envisaged the entry of 5+1 countries in 2002. In 1998 the summit meetings of the European Council decided to open official negotiations with 10+3 candidate countries. In October 2002, as a result of the negotiations, the European Commission proposed to the heads of states and governments to admit the accession of eight eastern European countries as well as of Cyprus and Malta in 2004. Bulgaria and Romania may join the Union in 2007 depending on a successful further preparation. The change of the European map is a historical step forward in the integration of the eastern and western parts of the continent. The enlargement is first of all a political action that provides new economic opportunities, but creates also not negligible risks. A main source of risks is the above mentioned increasing economic development gap within the Union.

2. Changes in the economic situation after the eastern enlargement

In the analyses two country groups are distinguished within the Union, the twelve more developed countries (EU-12) and the 3 southern countries, Greece, Portugal and Spain (EU-3). Also the central and eastern European countries are examined in two groups: five Central European countries, the Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia (CEEC-5), and three Baltic countries, Estonia, Latvia and Lithuania (CEEC-3). In dividing the countries into groups geographic and economic criteria played a role with per head GDP level as main factor. The main performance indices of the eastern countries compared to the EU average are shown in Table 1.

The picture is rather gloomy. In the eastern countries the comprehensive systemic changes were accompanied with a deep transition crisis and - in most cases - the development gap increased between the eastern countries and the Union during the past decade. With the exception of Hungary and Poland the industrial situation is still very weak, and the agricultural crisis affects the whole region yet.

In Table 2 the GDP and GDP per head level of the EU and the candidate countries provide a picture of the existing development gap among the different country groups. The first three column data are converted from national currencies to Euro on official exchange rates, while data of the second three columns are expressed in terms of purchasing power standards (PPS) (methodology and data by Eurostat).

Both calculations (with exchange rates and PPS) have their economic meaning. The data in Euro reflect the actual situation of prices and exchange rates in use and are related to fiscal and monetary policy. Calculations in PPS terms explore a deeper
economic reality concerning the development level of countries and - indirectly - living standards of the population, but have no direct impact on economic flows.

The GDP per head of present member states indicates that in the southern part of the Union the process of catching up is far from being finished. They are below average level in Euro by 38 percent and in PPS terms by 22 percent. The GDP per head of the EU-3 countries compares to the three highest level countries as 1:2 in Euro and as 1:1,4 in PPS.

The GDP per head level of the CEEC-5 countries is related to the EU average as 1:4,8 and of CEEC-3 countries as 1: 6,7 in Euro terms, in PPS respectively as 1:2 and 1:3 (rounded figures). All candidate countries’ GDP per head level is below that of the lowest member of the Union, and the difference among the eastern countries is much larger than among the present member states. The quantitative difference of the economic situation in the candidate countries expressed in these figures indicates a qualitative difference in the economic conditions.

The fact that the difference of the GDP per head levels between EU member states and eastern countries is larger in Euro than in PPS terms can be interpreted positively, as a sign that the development and living standard gap is smaller than on the first sight. But the gap in PPS is also large. At the same time the relation of Euro and PPS terms indicate also how much the currencies of eastern countries are undervalued, which may have a strong influence on the future economic policy of these countries. The comparison of Euro and PPS data reveal price and exchange rate level differences sharply.

The averages provide characteristic differences among country groups, but country by country data differ even more. The range among the developed countries (EU 12) goes from Denmark (0,82) to Italy (1,13) and the highest value of the multiplier among present members is that of Portugal (1,46), while among the eastern countries the lowest value is that of Slovenia (1,59) and the highest value that of Slovakia (2,78).

3. On the present concept of eastern enlargement

The Copenhagen Summit (June, 1993) determined the following criteria for accession:

- the stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- the existence of a functioning market economy;
- the capacity to cope with competitive pressures and market forces within the Union;
- the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union (In: A. Blahó (ed.) p.544).

The accession criteria were not quantified, but qualitatively well defined and provided guidance on the requirements to be achieved for accession by the eastern countries. It is important to mention that the accomplishment of the Maastricht criteria is not a precondition of the entry. The proposal of accession in 2004 acknowledges that eight eastern countries accept and fulfill - with some mutually agreed derogation - the established accession criteria.

### Table 2: GDP and GDP per head, 2000 at current market prices

<table>
<thead>
<tr>
<th>Country group</th>
<th>GDP per head Billion ECU</th>
<th>GDP per head ECU</th>
<th>GDP per head EU15=100</th>
<th>GDP per head PPS</th>
<th>GDP per head ECU</th>
<th>GDP per head EU15=100</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU 12</td>
<td>7679</td>
<td>24131</td>
<td>7471</td>
<td>23477</td>
<td>7679</td>
<td>24131</td>
</tr>
<tr>
<td>EU 3</td>
<td>846</td>
<td>14098</td>
<td>1054</td>
<td>17564</td>
<td>846</td>
<td>14098</td>
</tr>
<tr>
<td>EU 15</td>
<td>8525</td>
<td>22539</td>
<td>8525</td>
<td>22539</td>
<td>8525</td>
<td>22539</td>
</tr>
<tr>
<td>Czech R.</td>
<td>35,0</td>
<td>5954</td>
<td>3355</td>
<td>13911</td>
<td>35,0</td>
<td>5954</td>
</tr>
<tr>
<td>Hungary</td>
<td>50,3</td>
<td>5018</td>
<td>1115</td>
<td>11482</td>
<td>50,3</td>
<td>5018</td>
</tr>
<tr>
<td>Poland</td>
<td>171,0</td>
<td>4424</td>
<td>3421</td>
<td>8851</td>
<td>171,0</td>
<td>4424</td>
</tr>
<tr>
<td>Slovakia</td>
<td>20,9</td>
<td>3870</td>
<td>58,1</td>
<td>10575</td>
<td>20,9</td>
<td>3870</td>
</tr>
<tr>
<td>Slovenia</td>
<td>19,5</td>
<td>9804</td>
<td>31,0</td>
<td>15586</td>
<td>19,5</td>
<td>9804</td>
</tr>
<tr>
<td>CEEC 5</td>
<td>317,7</td>
<td>4774</td>
<td>682</td>
<td>10278</td>
<td>317,7</td>
<td>4774</td>
</tr>
<tr>
<td>Estonia</td>
<td>5,5</td>
<td>3830</td>
<td>12,4</td>
<td>8635</td>
<td>5,5</td>
<td>3830</td>
</tr>
<tr>
<td>Latvia</td>
<td>7,7</td>
<td>3186</td>
<td>15,9</td>
<td>6578</td>
<td>7,7</td>
<td>3186</td>
</tr>
<tr>
<td>Lithuania</td>
<td>12,2</td>
<td>3901</td>
<td>27,6</td>
<td>7468</td>
<td>12,2</td>
<td>3901</td>
</tr>
<tr>
<td>CEEC 3</td>
<td>25</td>
<td>3365</td>
<td>56</td>
<td>7405</td>
<td>25</td>
<td>3365</td>
</tr>
<tr>
<td>CEEC 8</td>
<td>342,2</td>
<td>4630</td>
<td>738</td>
<td>9985</td>
<td>342,2</td>
<td>4630</td>
</tr>
</tbody>
</table>

### Table 3: PPS and euro data comparison, 2000 at current market prices

<table>
<thead>
<tr>
<th>Country groups</th>
<th>GDP per head PPS</th>
<th>Multiplier</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU 12</td>
<td>24131</td>
<td>0,97</td>
</tr>
<tr>
<td>EU 3</td>
<td>14098</td>
<td>1,25</td>
</tr>
<tr>
<td>EU 15</td>
<td>22539</td>
<td>1</td>
</tr>
<tr>
<td>Czech R.</td>
<td>5354</td>
<td>2,46</td>
</tr>
<tr>
<td>Hungary</td>
<td>5018</td>
<td>2,29</td>
</tr>
<tr>
<td>Poland</td>
<td>4424</td>
<td>2,00</td>
</tr>
<tr>
<td>Slovakia</td>
<td>3870</td>
<td>2,78</td>
</tr>
<tr>
<td>Slovenia</td>
<td>9804</td>
<td>1,59</td>
</tr>
<tr>
<td>CEEC 5</td>
<td>4774</td>
<td>2,15</td>
</tr>
<tr>
<td>Estonia</td>
<td>3830</td>
<td>2,25</td>
</tr>
<tr>
<td>Latvia</td>
<td>3186</td>
<td>2,06</td>
</tr>
<tr>
<td>Lithuania</td>
<td>3301</td>
<td>2,26</td>
</tr>
<tr>
<td>CEEC 3</td>
<td>3365</td>
<td>2,20</td>
</tr>
<tr>
<td>CEEC 8</td>
<td>8139</td>
<td>2,17</td>
</tr>
</tbody>
</table>

In a stricter economic sense provisions of the accession criteria might be interpreted differently. The third criterion of accession mainly helped education and training in competition policy and behaviour. However, the competitive force of the economies remained much below the level of present EU member countries, for a basic improvement would need much more resources and time. Also the ability of adherence to the aims of monetary union (the last element of the fourth criterion) raises strong doubts.

The negotiated requirements exerted deep influence on the economies of the candidate countries, but the financial aid and EIB investments remained far below the awaited and necessary level. The main problem concerning the consequences of enlargement is the lack of deeper analyses of the real economic situation, the social and economic structure of the future member states. In the decisions nothing is to be found on the real economic problems of integrating the eastern and western parts of Europe. No special economic programmes or measures were elaborated that would change the Union's general economic policy after accession or, particularly, take into consideration the consequences of the increased number of countries with a development level much lower than pre-accession average. The implied notion that economic differences and tensions will be solved after the unification automatically by the implementation of existing economic policies is misleading and even dangerous.

An influential means of economic policy within the Union is the common budget, though the role of the EU budget is often overestimated. The main economic advantage of integration does not originate in the assistance provided by the budget, but directly in the unification of the markets, in the creation of a big market commensurate with modern technologies. While all citizens of the integrated countries can enjoy the new possibilities, the economic benefit goes first to the developed countries and their companies that have stronger competitive force. The main function of the budget assistance - together with some other mechanisms like the increasing role of EIB loans - is to counterbalance this advantage to certain extent. Therefore the budget is of greater importance for the eastern countries.

The Nice Summit Meeting (February 2001) finally opened the way for eastern enlargement, but reinforced the decision that the financial assistance provided for the new members must comply with the 2000-2006 financial perspective and decisions on budgetary discipline will oblige also the new members. The decision that the ratio of EU contributions won't be increased simultaneously with enlargement involves deep contradictions. The conflicts of interests between contributor and net beneficiary countries were strong in all periods of the Community's development. Essentially, this is not only the conflict of different national interests, but also a conflict between the ambitious aims of economic integration and relatively small financial resources available for realising it. Enlargement increases the conflict by the entry of a large group of net beneficiary countries.

The data result from rough estimates and data of the two years were not prepared by identical methods, however the table provides a general picture on the situation. In the public opinion - mainly in the net contributor countries - the burden of the European integration is thought to be much larger than in reality. The figures demonstrate that the net contributions to the budget are relatively small and remain well below the 1.27 percent ceiling. Although the political implications are very complex, in the long run an increase of net contributions is inevitable or the pace of future integration will fall far behind expectations.

Germany is far the biggest contributor to the budget of the Union both in amount and related to GDP; however the table provides a general picture on the situation. In the public opinion - mainly in the net contributor countries - the burden of the European integration is thought to be much larger than in reality. The figures demonstrate that the net contributions to the budget are relatively small and remain well below the 1.27 percent ceiling. Although the political implications are very complex, in the long run an increase of net contributions is inevitable or the pace of future integration will fall far behind expectations.

Germany is far the biggest contributor to the budget of the Union both in amount and related to GDP; however the table provides a general picture on the situation. In the public opinion - mainly in the net contributor countries - the burden of the European integration is thought to be much larger than in reality. The figures demonstrate that the net contributions to the budget are relatively small and remain well below the 1.27 percent ceiling. Although the political implications are very complex, in the long run an increase of net contributions is inevitable or the pace of future integration will fall far behind expectations.

Germany is far the biggest contributor to the budget of the Union both in amount and related to GDP; however the net German contribution is also below one percent. While Germany opposes the increase of the share of EU contributions it supports eastern enlargement. The turn in Germany's behaviour toward financing the European integration came to the fore after the unification of the country. "... The net German contribution to the 1995 budget was only approximately one-tenth of the German govern-

### Table 4: Net receipts from (+) and net contributions to (-) the EU budget

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>307.4</td>
<td>-733</td>
<td>-93</td>
<td>-0.37</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Belgium</td>
<td>-188.1</td>
<td>+121</td>
<td>+12</td>
<td>+0.06</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>-108.1</td>
<td>+537</td>
<td>+103</td>
<td>+0.39</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>+80</td>
<td>-67</td>
<td>-1</td>
<td>-0.01</td>
<td></td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>-2801</td>
<td>-67</td>
<td>-1</td>
<td>-0.01</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>-13834.1</td>
<td>+9869</td>
<td>+122</td>
<td>+0.52</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Greece</td>
<td>+3812.6</td>
<td>-5391</td>
<td>-55</td>
<td>-4.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ireland</td>
<td>+1726.9</td>
<td>+1846</td>
<td>+522</td>
<td>+3.63</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>-2805.7</td>
<td>-211</td>
<td>-4</td>
<td>-0.03</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Luxembourg</td>
<td>+249.8</td>
<td>+2462</td>
<td>+251</td>
<td>+3.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>-1811.1</td>
<td>-1184</td>
<td>-78</td>
<td>-0.37</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portugal</td>
<td>+1880.9</td>
<td>+2462</td>
<td>+251</td>
<td>+3.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spain</td>
<td>+3096.0</td>
<td>+7945</td>
<td>+205</td>
<td>+1.78</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>-727</td>
<td>-727</td>
<td>-84</td>
<td>-0.40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>-1585.4</td>
<td>-3614</td>
<td>-63</td>
<td>-0.42</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Column A: Net receipt per head. Column B: Net receipt as percentage of annual GDP.

Source: For 1994 data L. Tsoukalas, p. 218, for 1995 data A. Mayhew, p. 303, prepared on the basis of the Reports of European Court Auditors; Figures of column A in 1994 and of column B in 1995 are own calculations.
ment transfer to the New Bundesländer in that year” (A. Mayhew, p. 351). The large financial difficulties that accompanied the unification are behind the German stand, but do not prove necessarily this attitude. In our view the main problem of the German unification was that after the elimination of trade and other barriers and the prompt introduction of the DM in the Ostländer, market forces of the stronger partner got the opportunity to act freely, while the weaker partner’s enterprises suffered bankruptcy en mass. The process could not be counterbalanced even by immense state financial transfers since local producers were able to respond positively and a part of the money went back into the hands of western actors. The aid was more successful in social compensation than in escaping from a large fall in the economy. Anyway a similar situation must be avoided after eastern enlargement, and a policy of financial reservation would be a negative answer to the needs of the future Europe.

4. Selected topics

In order to diminish and, finally, to close the gap between the western and eastern parts of Europe three topics would need particular attention:

- Economic policy, for it exerts the greatest influence on and is the focal point of the future economic development;

- Agricultural policy, as the Union intends to change the Common Agricultural Policy (CAP) diminishing the financial resources put into it, while for the eastern countries the recovery and development of agriculture is a political and economic necessity;

- Transport, communication and information infrastructure policy, the development of which needs large resources for promoting the rapid and harmonic evolution of eastern markets.

Economic policy

In the present economic policy of the Union two main groups of means will have the greatest influence in the eastern countries. First, the monetary and fiscal provisions as determined in the Maastricht criteria (officially named convergence criteria) and in the Stability and Growth Pact, and second, the different funds (agricultural, structural, regional and cohesion). A possible and proposed alternative economic policy would implement a more differentiated and flexible macroeconomic policy and a growing but more concentrated use of financial resources. A policy mix is proposed that is more open for considerations of the real economic situation of the candidate countries. A policy with more attention to particularities of the economic circumstances could have been more efficient already in the preparatory period and - considering the new conditions that develop after the eastern enlargement, - changes in the policy should be introduced as soon as possible.

Arrangements of the Maastricht Treaty and their consequences on the economic development of the Union have been discussed in several publications and a detailed elaboration of the theme is outside the scope of this study. But, for its special importance, the impact of the economic policy provisions on the future development of the Union and particularly on the new member states must be treated here. The Maastricht criteria are biased from two important economic policy point of view. First, they impede the needed flexibility of economic policy in time, or in other words, they don’t take into consideration the phases of economic conjuncture. The belief that uniform and steady criteria would prevent cyclical growth was several times contradicted by facts and if slowdown or recession appear the unchanged criteria work as a straitjacket. Recent events in the Union prove again this statement. Second, they neglect the differences in the countries development levels. Consequently they restrain economic growth and retard - against their official name - the convergence of less developed countries, which is a fundamental failure in the enlarged Community.

A uniformed macroeconomic, monetary and fiscal policy would prevent the eastern countries from developing a more dynamic GDP growth and related investment and consumption policies in the long run. If the long-term annual rate of growth would be between 2,5 and 3 per cent in the West, eastern countries would need a twice as high rate of growth. Without a significant and steady difference in the growth rates only a very slow change would occur in the existing development gap and large structural differences would long survive within the Union. (See a quantified discussion of the problem in the Appendix of the paper: GDP growth projection.)

The main objective of economic policy concerning the eastern countries (but also for the Union as a whole) should be the dynamism of growth in the coming decades. The two sides, supply and demand need strength for reinforcing the weak domestic markets in the eastern countries, which is also a precondition of the common development of the enlarged Union.

The existing provisions and conditions wouldn't
allow maintaining the needed difference of the growth rates in the long run, thus would conserve the backwardness of several member states in the East and South. Past experiences support such a statement. The advance of Portugal, Spain and Greece toward the average development level of the EU was slow and varying in time, and the general rate of growth in the nineties remained below the real economic potential of the Union. With the enlargement the extension and weight of less developed countries will increase to a great extent. Therefore, instead of creating lots of exceptions and special arrangements, the use of which would be inevitable and turn soon uncontrollable, the making of economic policy should take into account major differences of development levels, and its measures should be differentiated accordingly.

In 2000 the relation of eastern countries to the Maastricht criteria differed in many respects (Table 5).

The great variety of the data reflects differences in the past and in recent economic policies. Only two countries, Latvia and Lithuania fulfil the Maastricht criterion of inflation rate. The given short-term interest rate data do not correspond to the interest rate criterion of Maastricht fully, but characterise the situation; in two countries (Slovakia, Slovenia) the indices fall below the inflation rate that is, of course, unsustainable. Three countries’ general government deficits answer positively to the three percent ceiling (Slovenia, Estonia and Latvia). The general government debt figures fulfil the 60 percent criterion; the Baltic countries, Slovakia, and Slovenia that gained independence after 1989 started the new era with no or very low indebtedness and their debt ratios remain strongly below the ceiling. The data on current account deficits has been added to the table for they announce in advance the possible foreign financial difficulties of the eastern economies; these ratios point to the large vulnerability of the financial position of the countries. Less the actual inflation and financial position of the countries may cause anxieties but more the possible future evolution of the key figures.

The undervalued currencies (see Table 3) seem suggesting a policy of systematic appreciation for lowering the inflation rate. However, a policy of rushed appreciation would evolve further difficulties for a better development of the candidate countries. It would make imports cheaper that would help keep down inflation to a certain degree, but won’t be able neither to counteract fully the inflationary pressure, nor to equalise by lower material prices the loss in the competitive position of exports. One of the strongest factors that caused the transition crisis was the sudden opening of the markets for western imports. A new similar wave would impede the acceleration of growth since the domestic supply side factors are still very weak. The need for large new investments, easing of social tensions, increasing the extremely low wage levels would certainly keep inflation on a higher level than allowed related to the best inflation rate western countries. At the end such a policy orientation would brake the very needed development of the regions domestic markets.

A study of United Nations Economic Commission for Europe states: “One of the important policy dilemmas facing the candidate countries is the conflict between the goals of achieving real and nominal convergence [i.e. complying Maastricht criteria] if these are to be pursued simultaneously. There may be a trade-off between the rate of nominal convergence (and hence accession to EMU) and the speed of real convergence, at least in the short run. …The long-run benefits of a fast EMU accession may outweigh the short-term costs associated with accession” (Economic Survey of Europe, p. 193.) However, the development gap is so large and needs so long lasting differentiation between the growth rates for achieving real convergence that the conflict between real and “nominal” convergence has long-term character. EMU accession would provide only a short-term push in increasing growth rates since when once EMU accession happens, diminished financial cost level would become general and loose its special stimulating effect.

The Hungarian National Bank, for instance, launched a policy of appreciation of the forint in the spring of 2001. The forint/Euro exchange rate diminished from 267 in April 2001 to 242 in April 2002.
an appreciation of the forint by 9.2 percent. The change contributed to improve inflation rate, but also to the recent deterioration of the foreign trade and current account balance. It started to undermine the position of foreign companies in the country and caused large losses to small and medium enterprises interested in exports. The corrective measures will cause slower growth of the domestic aggregated demand and GDP. Therefore, the general economic position of the country worsened and not improved; consequently the policy of currency appreciation won't be sustainable in the medium-term.

The arguments mentioned do not say to negate the importance of exchange rate corrections and would not exclude appreciation from the implemented policy mix. What is discussed here are the priorities of diminishing inflation rates and currency appreciation at any costs when the positive turning point is far in the future, even cannot be seen at all. A consequence of this opinion is that the introduction of the common currency could be prepared only in a longer perspective and not soon after the accession to the Union.

The problems of fiscal policy are not easier than those of the monetary policy. Low development levels are generally accompanied with strong scarcity of investment capital. During the transition the role of foreign direct investments (FDI) was more important in economic terms than any other factor (Table 6). However, foreign direct investments alone won't be able to satisfy the requirements of an adequate rate of growth and structural adjustment. Experiences since 1989-1990 show that foreign direct investments are not sufficient, spread among the countries unequally and don't contribute to the development of domestic middle and small-scale industries and agriculture.

The eastern economies have twofold interests concerning FDI. In order to make their economies more dynamic, FDI need to be maintained and increased, but in the last decade foreign companies occupied in several branches a dominating role and crowded out or impeded to develop domestic enterprises. In the eastern countries foreign companies have usually a competitive advantage in comparison with domestic industries, agriculture and commerce. Therefore a special assistance provided to domestic middle and small enterprises is important for both economic and social reasons. High emphasis should be put on such policies for achieving higher growth rates and diminishing social tensions. Beyond FDI the eastern countries would need in the future to raise money in different other forms too.

The fight for keeping budget deficits under control is a general duty of economic policies. If the economic tensions in the eastern countries are considered it is obvious that investment money raising is much more difficult in their cases than in the more developed countries. The question is what is a better solution: to prescribe for them the same budget and debt ceilings as for the developed countries or to let for them more flexibility. The former case would increase the pressure for EU funds or kill the growth perspective. Consequently another solution has to be elaborated and introduced.

In order to be efficient financial resources should be used to assist development at those weak points of the economies from which the maximum direct and indirect returns in economic and social terms are awaited.

**Agriculture**

Agriculture enjoyed distinction in the economic policy of the Community from the very beginning of its existence. The Treaty of Rome determined the objectives of the agricultural policy as follows:

"The objectives of the common agricultural policy shall be:

a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour;

b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;

c) to stabilise markets;

d) to assure the availability of supplies;"
e) to ensure that supplies reach consumers at reasonable prices." (Article 33, para. 1. of the Rome Treaty, consolidated text.)

The Rome Treaty gave - contrary to free market principles, - a special authorisation to the Council to grant aid "for the protection of enterprises handicapped by structural or natural conditions within the framework of economic development programmes" (Article 36).

The fact that more than half of the budget of EU was allocated to aiding the agriculture demonstrates the importance of agricultural policy. Such a concentration of resources resulted that dependence of Western Europe from food imports ceased and even overproduction of several agricultural products occurred, which evolved to a severe problem of the EU for a longer period.

The situation of agriculture in the eastern part of Europe changed in another direction after the Second World War. The development of agriculture was slow and varying in time, large shortages of agricultural products have arisen quite often. Later, in the seventies and the first part of the eighties, the relationships in the agrarian sector and its performance improved significantly in a number of candidate countries. In Hungary, for instance, several co-operatives and state farms achieved outstanding crops per hectare and good livestock proceeds. However, in the nineties, no real consideration of the structural adjustment policies existed and a deep agricultural crisis swept over the region (see table 1) that caused economic and social constraints.

Since 1989 agricultural output and quality of products are far below their previous levels, and - what is worse - plant structures are unsettled. The large majority of production co-operatives dissolved (except Poland, where collectivisation didn't happen), large state-owned farms have been divided into parts and partly privatised, or they have gone into bankruptcy. At present mostly small-scale (3-6 hectare) farms own the lands. These farms are unable to innovate and compete on a free market, and lack of adequate resources are typical for larger farms and the remaining co-operatives as well as state owned. The problems of agriculture have very important political implications, like in the West, also in the eastern countries. Therefore, at present all agricultural policy objectives determined in the Rome Treaty are valid and timely in framing the future of the new member states.

The agriculture has taken a large place in forging the Community and the improvement of its conditions is a necessity for making accession a success story in the eastern countries. The share and role of agriculture is more extended in the candidate countries than in the member states.

The regional policy, though important, cannot be a substitute to the agricultural policy. The regional structure in the eastern countries is less developed than in the West and - with the exception of Poland - show more similarities with the historical structure in France than in Germany. The regional policy of the Union moves forward the development of a more rational territorial structure, but causes tensions even in such a developed country like France. An accelerated regional policy would create in the after accession period unnecessary difficulties and could not contribute effectively to the solution of the agricultural problems. The regional assistance is needed first for building regional centres and education and health institutions, transport and communication infrastructure. These are costly investments with long-term return. In the regional policy, beside its own demand, the agriculture has a secondary place. While regional policy contributes to the agricultural development to a limited extent, the other way round, a more intensive agricultural development would assist efficiently the evolution of regional centres.

The dual problems of agriculture in the East and West don't equalise each other, but are adding together into a crucial problem of the enlargement policy. If a harmonious solution won't be found, the success of enlargement is in danger. The aim to decrease funds for supporting agriculture and the derogation of eastern countries to give equal treatment, add oil to the fire. The way out of this trap should be sought in the following directions:

<table>
<thead>
<tr>
<th>Country</th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>3.7</td>
<td>5.2</td>
<td>25.3</td>
</tr>
<tr>
<td>Hungary</td>
<td>4.9</td>
<td>7.1</td>
<td>36.0</td>
</tr>
<tr>
<td>Poland</td>
<td>3.8</td>
<td>19.2</td>
<td>34.4</td>
</tr>
<tr>
<td>Slovakia</td>
<td>4.5</td>
<td>7.4</td>
<td>42.6</td>
</tr>
<tr>
<td>Slovenia</td>
<td>3.6</td>
<td>10.2</td>
<td>49.6</td>
</tr>
<tr>
<td>CEEC 3</td>
<td>4.0</td>
<td>13.8</td>
<td>34.4</td>
</tr>
<tr>
<td>Estonia</td>
<td>5.7</td>
<td>9.5</td>
<td>31.4</td>
</tr>
<tr>
<td>Latvia</td>
<td>4.0</td>
<td>18.8</td>
<td>31.0</td>
</tr>
<tr>
<td>Lithuania</td>
<td>8.3</td>
<td>18.6</td>
<td>31.6</td>
</tr>
<tr>
<td>CEEC 3</td>
<td>6.6</td>
<td>16.9</td>
<td>31.5</td>
</tr>
<tr>
<td>CEEC 8</td>
<td>5.7</td>
<td>14.1</td>
<td>35.9</td>
</tr>
<tr>
<td>EU 12</td>
<td>1.7</td>
<td>4.6</td>
<td>19.1</td>
</tr>
<tr>
<td>EU 3</td>
<td>3.7</td>
<td>11.3</td>
<td>27.7</td>
</tr>
<tr>
<td>EU 15</td>
<td>1.9</td>
<td>5.7</td>
<td>20.5</td>
</tr>
</tbody>
</table>

Note: The methods of preparation may differ among the countries, the data provide a rough picture of the situation. Agricultural data include hunting and forestry. A: in 1999, B: in 1998 or available nearest year, C: in 2000. A: EU country data are incomplete, but data are representative for the group.

- The elaboration and implementation of a macro-policy that gives preference to high growth rates in the Union as a whole and particularly in the less developed countries of the Union is a precondition for solving the problems of the agriculture. In tendency the population living from agriculture is declining also in the eastern countries (although after 1989 a transitory increase occurred in some countries), but is still much higher in the East than in the West (see Table 7). Such a policy would allow a steady increase of consumption of agricultural products for which there is a large need but no purchasing power in the eastern countries.

- A research program should be launched urgently in order to reveal real land ownership and farm rent relations in the eastern countries and a program should be prepared how these relationships could be modernised and developed. The structural adjustment policy should be elaborated in a way to improve the living circumstances and standards of the population living from the agriculture.

- The agrarian policy measures should be revised taking into consideration the needs of both the East and West. A smaller rate of support for the eastern countries' agriculture is against basic principles of the Union and unacceptable even for a transition period. However, due to the deep differences between the two parts, equal treatment of East and West shouldn't mean the strict application of the same methods.

Since great differences exist in the past agrarian evolution and the present situation among the eastern countries, the elaboration and implementation of such a policy could be efficient only if it is done in close cooperation between the Commission and national governments.

**Transport, communication and information infrastructure**

One of the most important bases of an integrated common market is the transport of goods and persons, and built communication and information technologies. The backwardness and bottlenecks of transport and communication within the eastern countries and particularly in the east-west connections may restrain the integration process significantly. Furthermore, the new information revolution could unfold in most countries of East only recently and achieved a much lower level than in the West. A study prepared by experts of the Commission and of the interested countries (TINA, October 2001) estimated primary costs of the transport development needs of eastern countries until 2015 to 91 billion Euro, 1.5 percent of their cumulated GDP. Available resources are far below that level. The White Paper of the Commission on the European Transport Policy until 2010 (p. 95) calls to attach particular attention to the subject in the preparation of the financial perspective after 2006 and suggests to mobilise large private resources through EIB.

The adoption of a priority development program of transport, communication and information infrastructure could stimulate growth in the whole European area. It would

- broaden the market creating the fundamentals of economic growth and commerce in previously backward regions;
- provide large recommendations for planning institutions and many branches of the industry in East and West;
- raise the number of jobs and diminish unemployment in East and West;
- contribute to a higher growth rate in the Union with a special impetus to modernisation and increase of living standards in the eastern part of Europe.

A great advantage compared to the past in preparing such a plan in our age would be that environmental aspects could be considered and built in fully. Many elements of such a plan already exist, but a complex reformulation, an optimal combination of different possibilities would better serve societies and bring large savings at the same time. Four resources could provide the means for the projects: 1. Union and 2. national funds, 3. resources of interested companies, 4. collection of other private finances. To solve the immense task of financing a specialised investment bank should be established either as subsidiary of the European Investment Bank (EIB) or independently, but as an integrated element of the EU banking system.

5. The future of eastern enlargement

It is not difficult to foresee that the accession of the eight Eastern European countries plus Malta and Cyprus, and of Bulgaria and Romania in 2007 would need a longer period of accommodation and exhaust the development resources of the Union for a period. However, the eastern enlargement cannot be thought to be finished by the borders of the ten countries. In
two directions further steps would be needed and should be offered in the not too far future: toward the East (Russia, Belorussia, the Ukraine and the Republic of Moldova) and toward the south-eastern countries.

An opening toward Russia, Belorussia and the Ukraine is first of all a technological necessity in energy cooperation and developing the continents’ transport and communication systems. Further, for CEEC countries (and perhaps for the western part of Europe too) a standing economic upswing is unimaginable without a dynamic growth of economic and trade relationships with these countries. However, geographical features, number of the population, differences in historical traditions and internal economic relationships would impede to bring on the agenda the accession of them for long. The well proved methods of the association (Europe) agreements could provide the form in which the contradictory situation could be best bridged.

In the case of south-eastern countries (Albania, Croatia, Yugoslavia, Bosnia-Herzegovina, the Former Yugoslav Republic of Macedonia) firstly the recent history, the wars and their political consequences cause difficulties for more intensive economic connections. Hopefully, a political stabilisation would go forward in the area in which the assistance of the EU should play a leading role. An improvement of the political atmosphere would raise also the need for building normal economic relations with these countries. The burden of economic stabilisation and development in south-eastern Europe will be large, but the undertaking of the costs is inevitable for peace and stability in Europe as a whole and in particular for Greece and Turkey.

6. Conclusions

The future policy of the enlarged Union should focus on dynamic economic growth. This policy is in contradiction with Article 105 of the Treaty on the European Union that puts price stability and, as a consequence, the government deficit ceiling before other economic policy objectives. It is time to revise this point of the actual economic policy. Fixed and equally strict monetary and fiscal policy provisions implemented to countries on deeply different development levels combined with the use of a number of financial funds to counterbalance negative effects of them form a wrong policy mix. A new combination of economic mechanisms should be elaborated. In the coming 15-20 years the eastern policy of the Union should put special emphasis on the development of the regions’ agriculture as well as on the transport, communication and information infrastructure.

What kind of advantages the enlargement could provide to the highly developed countries of Europe? The companies would be the first winners of an enlarged common market. New investment possibilities could start up a long-term growth period for the Union as a whole that could improve the living standard of the population. The price to be paid by the developed countries is mainly an initial financial assistance to launch the process of East-West integration.

On the other side for the countries of Eastern Europe the accession provides a unique chance to accelerate development, adjust and modernise their economies and thus improve the living standard and circumstances of the population. However, the needed adjustment will ask from the eastern countries to make their own efforts, without which raising the growth rate on the needed level won’t succeed.

Among the principles of the Union equal chances and social cohesion have high rankings. Agricultural and other structural funds, as well as the regional and the cohesion funds are examples for a policy that assists acceleration and sustaining of development by targeted means. The cohesion fund has been set up with the aim to strengthen the Union’s economic and social cohesion and, particularly, “reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions or islands, including rural areas” (Article 158.). With the enlargement the scope of this task will be extended to large areas and even whole countries, which is impossible without adjustment.

The analysis of the economic situation and policy reveals a deep contradiction between the political will and the established economic policy. In a short period the political power might be stronger and can create without major changes some improvements, but in the long run, if adequate changes will lag behind, the impact of the economic policy will dominate over the political aims. The development of a single market cannot flourish if domestic markets of large areas cannot move forward or even decline, only prosperous domestic markets can give real strength to the common market.

At the beginning of such a historical change the possibility of temporary failures should also be considered, for they may discredit the idea of European integration and have a longer-term negative effect. Risks of the enlargement are great and what is worse they are often neglected. If adequate economic measures and a significant narrowing of the development
gap won’t sustain the process of political integration, in a crisis situation, centrifugal forces may endanger the results achieved before.

Nowadays, as the EU and a major group of eastern countries are near to leave behind the difficult twelve-thirteen year period of deciding and preparing the enlargement, and new development possibilities open for the region as a whole, - new fundamental policy decisions are before the people and their governments in both parts of the continent.

References:
András Blahó (Ed.): Basics about European Integration, (Európai Integrációs Alapismeretek), in Hungarian, Budapest, 2002.

APPENDIX

GDP growth projection

Introduction
The aim of making GDP growth projections in this study is to illustrate the size of the problem of convergence that arises with the eastern enlargement of the EU. A very simple methodology was chosen and applied in three scenarios, consequently, the projections cannot be interpreted as forecasts.

Methodology and database

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Remark</th>
<th>Symbol</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP of the base year</td>
<td>at market prices</td>
<td>a</td>
</tr>
<tr>
<td>Population</td>
<td>of the year x</td>
<td>b(x)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>a/b(x)</td>
<td>c(x)</td>
</tr>
<tr>
<td>GDP growth rate</td>
<td>annual average at constant prices</td>
<td>q</td>
</tr>
<tr>
<td>Year</td>
<td></td>
<td>x</td>
</tr>
</tbody>
</table>

The implemented equation: \( a^*q^n / b(x) = c(x) \)

Country groups:
EU 12 = twelve members of EU (except Greece, Portugal, Spain)
EU 3 = Greece, Portugal, Spain
EU 15 = the fifteen members of EU
CEEC 5 = Czech Republic, Hungary, Poland, Slovakia, Slovenia
CEEC 3 = Estonia, Latvia, Lithuania
CEEC 2 = Bulgaria, Romania
CEEC 10 = the 8 plus 2 eastern countries

Into the projections Bulgaria and Romania are included as it is likely that in a medium perspective they also will be EU members.

The q parameter is periodically applied for ten-year periods. In selecting the q parameters economic cycles were taken into account and 2 base periods were calculated:
- for EU countries: 1985-1993 and 1994-2000,
- for the Eastern European countries: 1980-1989 and 1994-2000, the bottom years of the crisis, i.e. 1990-1993 were left out.

The following statistical data (served the selection of the q parameters (Table 8-9).

Statistical values and selected values of the q parameters are as follows in Table 10.
The three scenarios are composed in the way table 11 shows.

The assumption in the baseline scenario is that growth in the Union will keep the pace of the last fifteen years; in the case of the eastern countries also in the baseline scenario some reasonable improvements are supposed hoping that the years of deep crisis are over. The second scenario includes that after 2010 more significant improvements will take place in the eastern new member states than in the western part of Europe and that from 2040 integration results in high growth rates. In the third scenario high growth rates are calculated already from 2020 for examining the perspective of convergence under good conditions. All scenarios imply that in all groups of countries the years of slowdown or recession will be counterbalanced by years of higher than average rates of growth. This assumption endows optimistic character to all scenarios since the period of projection is half a century, but the intention in selecting growth rates was to remain in realistic ranges.

The population totals \( b(x) \) are taken from the medium-variant of the United Nations last population estimates and projections (Table 12).

Different counter-arguments could be advanced against the chosen methodology. A problem is whether GDP figures express correctly the development levels and differences. Several deficiencies of the GDP indicator are known, but economic theory and economic policy practice use it as a synthetic indicator of economic growth and for different analytical tasks. For many examinations other indicators suit better. As it is shown in the main document, the difference in purchasing power parities between the more and the less developed countries is much smaller than in actual currencies. Why calculations are not made taking the data in PPS terms? The first reason for making the presented projections is of technical character: statistical base and past experience for real GDP growth rates are only available on actual prices and exchange rates. PPS figures are derived from these data for analysis of certain aspects and calculations in PPS terms are more fictive. A second argument is that it would not be correct to combine growth rates received from GDP data at constant prices with PPS data that imply the assumption of exchange rate corrections. To close the gap between exchange rate and PPS data is far from being a technical task, such corrections have far reaching economic preconditions and consequences. Therefore, most likely the rates of growth in PPS terms were smaller and real convergence under similar conditions would need nearly the same time as shown in

| Tab. 8: Real GDP growth of EU countries, 1985 - 1993 and 1994 - 2000 |
|------------------------|------------------------|------------------------|
| Austria                | 127.0                  | 102.6                  | 118.2                  |
| Belgium                | 120.0                  | 102.0                  | 120.9                  |
| Denmark                | 110.2                  | 101.2                  | 124.0                  |
| Finland                | 108.6                  | 100.9                  | 136.1                  |
| France                 | 121.0                  | 102.1                  | 117.3                  |
| Germany                | 122.4                  | 102.8                  | 113.7                  |
| Ireland                | 140.4                  | 103.8                  | 186.5                  |
| Italy                  | 120.1                  | 102.1                  | 115.4                  |
| Luxembourg             | 169.4                  | 106.0                  | 146.3                  |
| Netherlands            | 127.4                  | 102.6                  | 126.4                  |
| Sweden                 | 109.8                  | 101.0                  | 124.5                  |
| United Kingdom         | 123.7                  | 102.2                  | 125.7                  |
| EURO 12                | 121.7                  | 102.2                  | 119.7                  |
| Greece                 | 112.0                  | 101.6                  | 122.4                  |
| Portugal               | 139.1                  | 103.7                  | 126.5                  |
| Spain                  | 128.8                  | 102.9                  | 126.2                  |
| EU 13                  | 122.2                  | 102.8                  | 122.7                  |
| EU 15                  | 122.3                  | 102.3                  | 120.3                  |

Note: Weights of aggregates were derived from 1999 GDP data.
Source: UN/ECE Economic Survey of Europe, 2001 No. 2., Eurostat Yearbook, 2001

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Czechoslovakia</td>
<td>115.1</td>
<td>101.6</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>114.7</td>
<td>101.5</td>
</tr>
<tr>
<td>Hungary</td>
<td>108.9</td>
<td>100.9</td>
</tr>
<tr>
<td>Poland</td>
<td>109.9</td>
<td>100.9</td>
</tr>
<tr>
<td>Slovakia</td>
<td>101.1</td>
<td>100.1</td>
</tr>
<tr>
<td>Slovenia</td>
<td>111.4</td>
<td>101.2</td>
</tr>
<tr>
<td>4/5 countries</td>
<td>125.5</td>
<td>102.6</td>
</tr>
<tr>
<td>Estonia</td>
<td>129.9</td>
<td>102.9</td>
</tr>
<tr>
<td>Latvia</td>
<td>135.3</td>
<td>103.4</td>
</tr>
<tr>
<td>Lithuania</td>
<td>131.5</td>
<td>103.1</td>
</tr>
<tr>
<td>3 countries</td>
<td>1,238</td>
<td>102.4</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>1,115</td>
<td>101.2</td>
</tr>
<tr>
<td>Romania</td>
<td>1,148</td>
<td>101.6</td>
</tr>
<tr>
<td>9/10 countries</td>
<td>1,135</td>
<td>101.4</td>
</tr>
</tbody>
</table>

Note: Weights of aggregates were derived from 1999 GDP data.
Source: UN/ECE Economic Survey of Europe, 2001 No. 2., Eurostat Yearbook, 2001

| Tab. 10: Statistical values and selected values of the q parameters |
|------------------------|------------------------|------------------------|
| Country groups         | Statistical values     | Variants               |
| EU 12                  | 2.2                    | 2.6                    |
| EU 3                   | 2.8                    | 3.3                    |
| CEEC 5                 | 1.2                    | 4.2                    |
| CEEC 3                 | 3.1                    | 2.5                    |
| CEEC 2                 | 1.6                    | 0.2                    |

| Tab. 11: Statistical values and selected values of the q parameters |
|------------------------|------------------------|------------------------|
| Country groups         | Statistical values     | Variants               |
| EU 12                  | 2.2                    | 2.6                    |
| EU 3                   | 2.8                    | 3.3                    |
| CEEC 5                 | 1.2                    | 4.2                    |
| CEEC 3                 | 3.1                    | 2.5                    |
| CEEC 2                 | 1.6                    | 0.2                    |
The calculations. The mirror in which we see the reality would be different, but the final result and conclusions were much similar.

Results of the projection and conclusions

For comparison, table 13 provides the data of the base year, 2000. The projected GDP per capita figures in 2050 are as in table 14.

The results demonstrate that while in the growth rates the difference seems to be significant, the convergence between the different groups of countries is less expressive and relatively slow. In the baseline scenario the five central European countries will improve their relative position from 21 to 45 percent and in the high scenario to 75 percent and that change would need fifty years. The group of ten candidate countries could improve their position from 17 percent to 34, 51 and 60 percent depending on the scenarios chosen.

The per capita GDP increase derives from two factors: the increase of the GDP growth rate and the decline of the total number of population. The contribution of the population decline to per capita GDP growth in 2050 is as in table 15.

There is some probability that higher than calculated total population figures may occur in the eastern countries as social conditions and health care will improve. Such changes would somewhat diminish the per capita GDP growth rates. In Hungary, for instance, a study (L. Hablicsek, 2002) discusses the applied population forecasts concluding that population decline will be less accentuated in the future than taken in the UN demographic forecast. Since similar situation has a probability in other eastern countries as well, the closing of the real GDP per head gap could be slower than in the elaborated scenarios.

Recently some optimistic views could be read about a rapid process of catching up on behalf of one or another country after the accession. A leap forward of one or another country may happen, however, such events would not disapprove the general conclusion of the projection. The aim of this small work was only to prove how difficult the task of convergence is and how much time, how many efforts are needed on behalf of all partners to achieve real success.
I will deal with the topic EMU and enlargement by proposing eight theses and commenting and elaborating on them.

**Thesis 1**

“Candidate countries’ real convergence with current Member States has so far been relatively modest and growth performance has been mixed. Average GDP per capita on a purchasing power standards (PPS) basis for all candidate countries reached 35.2% of the EU average in 2000 - basically the same level as in 1996. It ranged from below 30% in Bulgaria, Romania, and Turkey to 86.2% in Cyprus. Slovenia at 69.4% has the highest value among transition candidate countries. In addition, regional and rural-urban disparities in per capita incomes are considerable within some of the candidates” (European Commission 2002: ‘Report on Macroeconomic and Financial Sector Stability).

In 2001, average GDP per capita of the 12 accession countries (that is without Turkey) stood at around € 4,400 (at current exchange rates) and around € 9,100 (in purchasing power standards). That corresponds to about 20% and 40% of the Euro area average (the income levels of Portugal, Spain and Greece, at the time of their accession, amounted to around 60%-70% of the EU average). The large income and productivity gap distinguishes the ongoing enlargement from past experiences. Discrepancies of this magnitude have never been observed in previous EU enlargements. Real macroeconomic convergence, therefore, is a key focus of the political agenda today and in the future. The process of catching-up will take decades, not years, to reduce the gap significantly. Indeed, the process of real convergence has been rather slow during the last years.

If the need to catch-up with the EU in terms of both the real economy structures and income levels and the need to advance disinflation should be pursued as a “dual track”, as the ECB proclaims, there may be a conflict which, at least in part, depends on what often is referred to as the Balassa-Samuelson effect, i.e. productivity differentials between the tradable and the non-tradable sector. If the productivity growth in the first sector is faster than in the second the relative prices of non-tradables will raise relatively to tradables. And if wages in the tradable goods sector will increase corresponding to the productivity growth in this sector and if labour is mobile across sectors wages in the non-tradable sector will be driven up. This will raise costs (because the wage increase is not consistent with productivity growth) and prices in the non-tradable goods sector. The consequence is a rise in the overall price index. Empirical studies for the accession countries have estimated it at around 1% to 3% of inflation.

It remains open how important the Balassa-Samuelson effect really is: “the Balassa-Samuelson effect can only account for a limited share of inflation differentials vis-à-vis the Euro area in recent years” (ECB 2002, 58). There may be other explanations, including the policy-mix, wage inertia, inflation expectations as well as transition-related factors which continue to play a certain role in many accession countries.

In any case, inflation rates are higher, and possibly will be higher also in the future, in accession countries than in the Euro area. This implies that monetary and exchange rate policy need to take the “catching-up” component into account and that the policy objectives in accession countries might need to be different from those applied to high-income countries or to the Euro area. The strict respect of the Maastricht inflation criterion may be misleading. Possibly, the achievement of this criterion would jeopardise the catching-up process. And, if catching-up in terms of real per capita income may also imply an appreciation of the real exchange rate, exchange rate policy should allow for nominal adjustments.

**Thesis 2**

“The complete liberalisation of capital markets could exacerbate potential vulnerabilities if capital inflows should be poorly intermediated by the domestic financial sector and/or exceed the absorption capacity of the economy. There may be a tendency for foreign capital inflows to surge, especially as accession and participation in EMU approaches, as international ratings of candidate countries are being further upgraded, and as financial sectors expand and broaden the scope of investment opportunities. Experience shows that some of these capital inflows will be more short-term and more reversible and, hence, very sensitive to macroeconomic and structural policy stances” (European Commission 2002).
Although the pace of liberalisation differs across the candidate countries the early liberalisation of capital controls is one of the common features in central and eastern Europe. Estonia liberalised all flows at the beginning of transition. Slovenia and Hungary rely most on controls to regulate short-term capital flows. Czech Republic has abolished practically all controls. Other countries removed controls on long term capital. From an EU point of view, capital controls are inconsistent with the Single Market Program and must be abolished completely before joining EU. Since the accession countries have not requested any transition periods, it seems as if the capital liberalisation process will be completed upon accession.

The first consequence is that the countries get more vulnerable to excessive volatility of short-term capital movements. Short-term capital account liberalisation will make it easier for investors to take large positions against a currency. As the privatisation process is nearing completion, current account deficit financing have to rely on more shorter term, and easier to reverse capital inflows. This may exacerbate the country’s exposure to speculative attacks. Contagion effects probably will be more difficult to contain.

The second consequence of the liberalisation of capital markets during the last period were strong growing capital movements, especially net capital inflows. In 1996 - 2000, average annual FDI inflows in transition candidate countries ranged from 1.2% of GDP in Slovenia to 7.4% of GDP in Lithuania. There is, even if privatisation-related FDI inflows are coming to an end, the hope (or the fear) that such inflows will increase due to competitive labour cost, well-educated labour forces, proximity to Western Europe, the expectation of EU-accession, progress in structural reform, and the prospect of EU accession. The hope is that the capital inflows possibly will strengthen productivity growth, reduce the technological gap, and promote the restructuring process. The fear is that capital inflows may drive further up the exchange rates, so that the countries suffer an additional loss of competitiveness and further growing current account deficits.

Indeed, it seems as if the current account deficits that we can observe in all candidate countries were more a consequence of, than a reason for, the net capital inflows. As the overall balance of payments is always zero capital inflows have to be offset by a deficit in current account. The economic mechanism which produces the adjustment is the exchange rate. An overvalued real exchange rate, loss of competitiveness, rising imports and decreasing exports are the logical consequence. The average current account deficit of transition candidate countries in 2000 amounted to 5.0% of GDP (which is higher than the US-deficit!).

**Thesis 3**

"Currently, candidate countries’ exchange rate regimes run the gamut from currency boards to flexible, although to a varying degree managed, regimes, and there is no obligation in this area prior to accession. Many of the vulnerabilities previously identified such as high current account deficits, output fluctuations, capital inflows, combined with relatively high domestic interest rates, and of the real exchange rate appreciation being accomplished by inflation pose challenges that are appropriately dealt with the help of the exchange rate as a tool for adjustment. Candidate countries, with the exception of those having currency board arrangements, have been moving towards more flexible exchange rate regimes" (European Commission 2002).

Exchange rate regimes in central and eastern Europe exhibit remarkable diversity, covering the full spectrum from currency board arrangements to free floats. During the last years the regimes have not been static. The underlying factors behind these changes are disinflation and pressure from capital flows. In the early years of the transition process, systems of fixed rates worked as an effective device to anchor inflation expectations. Most countries opted for a fixed or tightly managed external anchor.

The fact that accession countries have made significant progress in disinflation over the past few years. Even if the inflation rates, (2001 ~ 9%) remained significantly higher that in the Euro area) reduces the need for an external anchor for monetary policies. In the second half of the nineties some countries moved towards greater exchange rate flexibility.

At the same time, persistently large capital inflows produce an upward pressure on the exchange rates. As a consequence, Poland adopted a less controlled exchange rate regime in the context of large capital inflows. The Czech Republic was forced to abandon its exchange rate band under the pressure of a currency crises (1997/98). Both countries have switched to direct inflation targeting. Also Slovakia and Romania moved in direction of more flexibility. On the other hand, Bulgaria, under the pressure of strong capital flows, substituted a currency board arrangement for a relatively free float. Overall, we can observe a tendency toward the more extreme ends of the spectrum: free floats in the Czech Republic and Poland, Currency Board Arrangements in Bulgaria, Estonia, Lithuania (and Herzegovina) and
unilateral Euroisation (if we take into consideration also Kosovo and Montenegro) (see appendix). Hungary opted to shadow Exchange Rate Mechanism (ERM) II with a +/- 15% fluctuation band.

**Thesis 4**

"Candidate countries' participation in EMU as new Member States with a derogation from the adoption of the Euro, the associated adoption of the EMU-related Community acquis, and the final goal of Euro adoption - for which the appropriate timing will differ from country to country - set clear orientations for their monetary and exchange rate policies" (European Commission 2002).

The EU-strategy is based on the experience of the Maastricht process with some, as we will see later, important modifications. During the accession we may distinguish four stages:

1) Preaccession phase: applicant countries are obliged to fulfil the 'Copenhagen criteria' (existence of a functioning market economy, capacity to cope with competitive pressure and market forces within the Union, the ability to take on the obligations of membership including adherence to the aims of economic and monetary union). Capital markets have to be liberalised. The adherence to the aims of EMU implies progress in nominal convergence including stability-orientated monetary and fiscal policies.

2) Accession to the EU: The new EU-member states also get member of the EMU, but with a special status. They are considered as "Member states with derogation". That means: exchange rate policy is treated as a matter of common interest (Article 124 of the Treaty, ex Article 109m), economic policy as a matter of common concern (Article 99), the central banks will become members of the European System of Central Banks (ESCB), they will be represented on the General Council of the European Central Bank but not on the Governing Council (where the monetary policy decisions are taken). Their position is similar to the status of Great Britain, Denmark or Sweden today with an important difference: no "opt-out" clauses, such as those negotiated by the United Kingdom and Denmark, shall be granted to new member States. Participation in ERM II is, in principle, voluntary for all the member states outside EMU. But it is expected that they join ERM II and, after a period of at least two years, EMU.

3) Joining ERM II: The countries link their currencies to the Euro. ERM II is based on central rates against the Euro with a fluctuation band of +/- 15% or less around central rates. ERM II is similar to the old EMR I, with some small, but important, modifications (we come back to this point later). Foreign exchange interventions at the margins are, normally, automatic and unlimited, but they can be suspended if this conflicts with the goal of price stability.

4) Full participation in the EMU: Participation in Stage Three of EMU will be subject to an examination of the (nominal) convergence situation. Here the Maastricht-criteria have to be taken into consideration. The growing number of participating countries will make it necessary to adapt the institutional structure of the ESCB (especially the composition of the Governing Council).

From a monetary policy point of view, the stages 3 and 4 are the most important. Especially the fact that all countries are obliged to participate in ERM II has important consequences for economic and monetary policies during the transition period: not only exchange rate regimes based on reference currencies other than the Euro are incompatible with the ERM II framework but also freely floating exchange rates, crawling pegs, and direct "Euroisation", i.e. the idea of adopting the Euro as legal tender. Not completely clear is what to think about the compatibility of currency board arrangements (CBAs) and ERM II. At the beginning, the ESCB pointed out that a CBA cannot be regarded as a substitute for participation in ERM II. In a recent statement the ECB seems to take a more 'flexible' position: "With regard to currency boards, the ECB does not consider them to be a substitute for participation in ERM II, implying that countries operating a currency board will be required to participate in ERM II for two years before adopting the Euro. ... However, countries that operate a Euro-based currency board deemed to be sustainable might not be required to go through a double regime shift, i.e. of floating the currency within ERM II and then repegging it to the Euro later. Thus, such countries may participate in ERM II with a currency board as a unilateral commitment, enhancing the discipline within ERM II. However, the ECB has stressed that such an arrangement will be assessed on a case-by-case basis and that a common accord on the central parity against the Euro will have to be reached."

Actually, applicant countries are free to choose whatever exchange rate system they prefer, prior to accession, although the perspective of membership will have a bearing on that choice. In any case, it is worth mentioning that the obligation to join ERM II is inconsistent with the directions in which exchange rate systems of the applicant countries developed during the last years.

Heft 3-4/2002 27
Thesis 5

A very interesting development is that the Euro is used all over central and eastern Europe (also in other parts of the world, especially Africa) as a parallel currency. The Euro is utilised by private agents with, or instead of, the domestic currencies.

The ECB estimates that the circulation of Euro outside the Euro area is close to € 18 billion (which represents nearly 7% of the Euro's total currency in circulation). Euro-denominated deposits are estimated to amount to more than € 13.5 billion. Currency substitution is accompanied by asset substitution.

The Euro is used as a parallel currency wherever the confidence in the domestic currency is weak, as a safe haven to store wealth and to carry out transactions. A second reason for using the Euro in central and eastern Europe may be the fact that the financial, economic, institutional, and political links with the EU are getting stronger. And this is true not only for the accession countries. The exchange rate regimes of the west Balkan countries, for example, are orientated to the Euro. This is supported by the European Council that granted them in June 2000, the status of 'potential candidates' for membership in EU.

There are no clear dividing lines between currency and asset substitution and 'Euroisation'. Kosovo and Montenegro have decided unilaterally to use the Euro as legal tender. But also in other countries the Euro is used to an increasing extent. In Bosnia, Euro-denominated bank deposits, as a share of total deposits, amount to 50% (Dec. 01), in Bulgaria to 15%, in Croatia to 71%, in Estonia to 21%, in FR Yugoslavia to 87%, in Hungary to 10%, in Macedonia to 40%, and in Slovenia to 37% (Mar 02). Obviously, there is a strong and growing pressure from private agents of central and eastern European countries to make use of the Euro. The ESCB has formulated, as far as I know, no definitive answer to how to deal with the phenomenon of Euroisation.

Thesis 6

Basically, the ECB's main policy positions on accession constitute a rerun of the Maastricht process, confirming all its advantages and disadvantages. But there are, at least, two fundamental differences. The first is: while the monetary integration process in western Europe envisioned capital market integration as an outcome of progress toward economic and monetary convergence (realised only in 1990, more than ten years after the launch of the European Monetary System (EMS)), the enlargement pro-

cess places the liberalisation of capital markets at the beginning of the whole integration process. Capital controls have to be abolished before joining EU (and, therefore, before joining ERM II). The priority attached to capital market integration can not simply be interpreted as a supplement to the liberalisation of commodity markets. Capital market integration is not necessary to obtain the benefits stemming from integration of commodity markets. The key factor responsible for the difference seems to be less concern in regard to efficiency than considerations of political economy: capital market integration is seen as an instrument of strengthening economic cohesion and forcing monetary policy of the new member states to adapt to EU-standards.

The question is whether this strategy is desirable, and furthermore, whether liberalising financial markets does not reduce the room for manoeuvre for monetary policy at the national level excessively. "Countries with fixed exchange rate regimes obviously have to gear monetary policy towards the exchange rate target" (ECB 2002, 58). The fact that integration of financial markets at fixed exchange rates constitutes a restraint on national policy independence is not a new insight: all approaches making reference to the Mundell-Flemming model are based on the idea that commodity and capital market integration, fixed exchange rates, and national monetary independence represent, in the global economic context, an 'inconsistent quartet' and cannot be achieved simultaneously.

If the controls on capital movements are abolished in an arrangement of fixed exchange rates the hands of monetary policy get tied to the external balance. The volume of foreign exchange at a central bank's disposal constitutes the country's budget constraint. The power of interventions is limited by the amount of reserves in foreign currency. Interest rate policy has to take on the key role, it being able to influence the relative attractiveness of both investments denominated in domestic currency and the currency itself. If monetary policy is assigned the role of maintaining a country's foreign-exchange liquidity, national monetary independence is forfeited because monetary policy loses its capacity to influence internal developments. For the candidate countries capital market liberalisation renders impossible any consistent orientation of monetary policy in direction of real convergence. Monetary policy cannot at the same time seek to maintain a country's liquidity in foreign exchange and, for instance, to regulate domestic price level. When countries participate in ERM II monetary policy has no choice. Losses of
foreign exchange become a sanction mechanism: any such losses force monetary policy to recognise the primacy of external stabilisation.

Therefore, if we take into consideration the differences in real income, the necessity of catching-up, the problems of the transition process, and the still existing structural and institutional differences then it is quite obvious that there are a lot of reasons for maintaining room for manoeuvre for monetary policy at the national level.

**Thesis 7**

**Relating to the two fundamental differences mentioned in Thesis 6, the second important difference between the Maastricht process and the strategy to integrate the new EU-member states into the EMU is the open asymmetry of the system (even if the German mark was the key currency of the EMS, its role as key currency was never recognised officially).**

The open asymmetry has important implications for the institutional structure of the ERM II. The asymmetric structure of the monetary relations in Europe permits the ECB to treat external stabilisation (exchange rates) as the task of the candidate countries. An important difference between the EMS and ERM II is that the ECB has the right to suspend automatic intervention if this were to conflict with its primary objective of maintaining price stability; and ERM II does not include the Short-Term Monetary Support mechanism and the swap operations as provided for by the ERM I. The 'Agreement between the European Central Bank and the national central banks of the member states outside the Euro area laying down the operating procedures for an exchange rate mechanism in stage three of Economic and Monetary Union (1 September 1998)' says in Article 3: "Intervention at the margins shall in principle be automatic and unlimited. However, the ECB and the participating non-Euro area NCBs could suspend automatic intervention if this were to conflict with their primary objective of maintaining price stability"; and in Article 7: "The very short-term financing facility is in principle automatically available and unlimited in amount for the purpose of financing intervention in participating currencies at the margins".

Even if it looks like a symmetrical arrangement on a legal level, it is not: in a situation of crises the ECB (due to its role, the monetary power, and the Euro it can create) is the only central bank that has the possibility to stabilise the system. In the ERM I a certain degree of symmetry was guaranteed by the fact that intervention at the margins and short-term financing were obligatory for all central banks. No central bank had the right to suspend intervention. In the new mechanism it is sufficient to declare that intervention is to conflict with the objective of maintaining price stability. The consequence is that, in a case of a conflict, the central banks of the new member states have the responsibility for the stability of the exchange rate, but not the currency, while the ECB has the currency, but no responsibility.

The currency crises in the Czech Republic and Turkey may give us an idea of the problems which may arise when the candidate countries join ERM II.

**Thesis 8**

**Monetary integration in Europe, from the start of the European Monetary System to the creation of the European Monetary Union and the introduction of the Euro, is a political project which, in a certain way, aims at a return to the logic of the gold standard of the nineteenth century, not in technical terms, but in the sense that money gets separated from politics.**

As Barry Eichengreen once said: the "politicization of the policy environment ... had destroyed the viability of the gold standard". What would have surprised the architects of the postwar international monetary system is the fact that "after World War II ... resurgent market forces ... overwhelmed the efforts of governments to manage their currencies" (Eichengreen 1996, 196). Eichengreen hoped that cooperative agreements might reconcile the desire for exchange rate stability with the pursuit of other policy goals. At this point he possibly was too optimistic. The foundation of the EMU is more than 'cooperative agreement between governments'. It is a project that, in a certain way, tends to reverse the 'politicization of the policy environment'. One source of the project is the idea that monetary stability and low inflation rates should be considered not longer as one political objective among others, but as a precondition to economic development. Central bank independence is a second cornerstone of the model. The introduction of the supranational money and the ESCB, finally, is the third essential part of the framework. The EU simply presumes that the candidate countries adapt their social organisations, economic institutions and politics to the conditions of the EU model. The candidate countries, indeed, have little choice. Fact is that the economic weight of the accession countries is small relatively to the Euro area, even if the population is over 100 million altogether (without Turkey). In 2001, the overall nominal GDP reached about € 460 billion, that is less
than 7% of the Euro area's GDP (comparable to that of the Netherlands). Monetary policy in the EMU is based on the conditions of the Euro zone as a whole, of which the new entrants would form only a small part. And it might not yet be appropriate for the new member states. The ECB will not take into consideration the special needs of any participating country, i.e. it will not include, for example, the promotion of the catching up process.

Candidate countries should have the possibility to determine the pace of adjusting to the EU model of monetary integration. Assuming a first eastward enlargement takes place in 2004, new member states could, theoretically, enter the Euro zone in 2006 at the earliest. From a purely formal point of view there is no need to follow this timetable. Even if it is expected that the candidate countries will join ERM II at some point in time after accession, ERM II membership does not need to happen immediately after EU accession, neither need ERM II membership to be limited to only two years.

Indeed, there are good reasons to postpone full membership in the EMU. A fixed exchange rate possibly is not favourable for countries that are still in transition. It would deprive the candidate countries of their independent monetary policy and constrain their fiscal policies. The new members may use the possibility to maintain inflation rates above the Maastricht inflation criterion for some time after they join the EU simply because nominal convergence ‘à la Maastricht’ may not be the best way to achieve real convergence. They may want to exploit some exchange rate flexibility also after having entered the EU. The countries will have the problem to avoid choosing an uncompetitive central rate. Market signals and market-determined rates may be misleading if they are based on strong capital inflows.

The main obstacle to a more flexible process, in order to give priority to economic growth and real convergence of income per capita, possibly will be the liberalised capital markets. Open capital markets exacerbate the country’s exposure to speculative attacks and make the countries vulnerable to excessive volatility of short-term capital movements. Even if the ultimate decision rests on each individual country, liberalised capital markets (and the necessity to prevent currency crises) will create a strong pressure, at an early stage, in direction of full membership in the EMU.

## References


Eichengreen, B. 1996: Globalizing Capital, Princeton.

Franke, J.A. 1999: No Single Currency Regime is Right for All Countries or at All Times, Princeton.


Kopits, G. 1999: Implications of EMU for Exchange Rate Policy in Central and Eastern Europe (IMF WP 99/9)


Padoa Schioppa, T. 2002: The Euro Goes East, 8th Dubrovnik Economic Conferences.
Enlargement and structural changes

1. Purpose of the paper

A historical glance backwards on the structural changes and economic benefits and cost of the completion of the single internal market of the EU (the 1992 programme) is cast as a tool to analyse and foresee the structural changes in connection with the enlargement process.

2. Can we learn from market integration and structural effects in the Cecchini report?

There are significant differences between the integration projects at the beginning of the 90’s, when the completion of the internal market for the EU - then 12 member states - was planned, and the further integration by enlarging the Community that now in 2002 are in front of us. There are differences in size, in time perspective, and substance, i.e. with respect to what structural changes are to be expected.

And yet it is tempting to pick up the various analyses of the Cecchini report and try to apply the results of this comprehensive and far-reaching study on the foreseeable enlargement of EU with a number of applicant countries.

In 1988 tariffs and quantitative restrictions on trade had been largely eliminated in the Community. Regarding agriculture monetary compensatory amounts were applicable. These varied between zero (for Denmark, Luxemburg) and 37 per cent (for Greece) in per cent of agro product prices. At the time the Cecchini report was written no specific reforms of the CAP system were at stake. Thus, the analysis did not include any reduction/abolition of tariffs on trade or import duties.

Analysis was concentrated on abolition of frontier controls, opening up of public procurement, liberalization of financial services and strategic reactions of firms on a changed competitive environment.

The method of the "Economics of 1992" included a microeconomic as well as a macroeconomic approach. The assessment of the consequences of the large internal market was based on both, the procedure had to begin at the microeconomic level.

The macroeconomic approach was necessary for three reasons: (1) most parts of the economic system were likely to be affected, as cost reductions, price reductions were interacting in the system and would give an impact on the purchasing power, competitive positions, the growth potential and substitution between factors of production, (2) an easing of the major macroeconomic constraints was likely and external deficits and inflationary pressures had to be taken into account, (3) the macroeconomic analysis could possibly throw light on the time perspective of the various processes involved in this remarkable market integration project.

Two econometric models were used: the Commission’s Hermes model and the OECD’s Interlink model for simulation and simultaneously making use of results from the microeconomic studies.

A few tables from the Cecchini study presented below summarize the most important estimates yielded by the study, viz. table 1 and table 2.

Leaving any customs tariff abolitions aside the table 1 is showing that the most important economic fac-

<table>
<thead>
<tr>
<th>Relative change</th>
<th>Frontier Controls</th>
<th>Public procurement</th>
<th>Financial services</th>
<th>Supply effects</th>
<th>Average</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>As % of GDP</td>
<td>0,4</td>
<td>0,5</td>
<td>1,5</td>
<td>2,1</td>
<td>4,5</td>
<td>(2,2-5,7)</td>
</tr>
<tr>
<td>Consumer prices</td>
<td>-1,0</td>
<td>-1,4</td>
<td>-1,4</td>
<td>-2,3</td>
<td>-6,1</td>
<td>(-4,5 to -7,7)</td>
</tr>
<tr>
<td>Absolute change</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employment ( x 1000)</td>
<td>200</td>
<td>350</td>
<td>400</td>
<td>850</td>
<td>1800</td>
<td>(1300 to 2300)</td>
</tr>
<tr>
<td>General gov’t borrowing requirements as a % of GD</td>
<td>0,2</td>
<td>0,3</td>
<td>1,1</td>
<td>0,6</td>
<td>2,2</td>
<td>(1,5 to 3,0)</td>
</tr>
<tr>
<td>External balance as a % of GDP</td>
<td>0,2</td>
<td>0,1</td>
<td>0,3</td>
<td>0,4</td>
<td>1,0</td>
<td>(0,7 to 1,3)</td>
</tr>
</tbody>
</table>

1 Scenario including the supply effects estimated by the consultants, the economies of scale phenomena (industry) and the competition effects (monopoly rents, X-inefficiency)

Source: Ref 1, page 159; Hermes and Interlink models. The Interlink simulations were conducted within the Commission services and the OECD is in no way responsible for them.

Tab. 1: Macroeconomic consequences of completion of the internal market; Community as a whole in the medium term
tor in the completion of the internal market was estimated to be the various strategic reactions of firms faced with a new competitive environment ("supply effects"). Some aspects of company strategy or performance had to be left out in the Cecchini analyses, for instance effects on innovation and transnational cooperation and mergers because of lack of models and sufficient know-how. To state things briefly, the simulation covered static effects but had to leave dynamic processes aside.

3. The role of macroeconomic policy in the Cecchini report

(Quotation from European Economy, The economics of 1992, No 35, March 1988, pp 164-165:)

"Given the current level of public deficits in the Community, the easing of this constraint (i.e. the improvement in public finances brought about spontaneously by completion of the internal market) should play a central role. In the event of all the room for manoeuvre available in the public deficit being used (second line in Table 2), Community GDP could be increased in the medium term by 7,5 % and employment by 5,7 million without any attendant increase in inflation (consumer price levels down by 4,3 % in the medium term). However, a deterioration in the Community’s external balance would have to be accepted (-0,5 % of GDP); this would be possible only if the Community’s external balance on completion of the large internal market were initially in surplus by an equivalent amount. Historically, such a surplus is high (on average 0,2 % of GDP since the beginning of the 1980’s). If the Dollar remains at the level obtained at the beginning of 1988, or if it continues to fall, there is unlike-ly to be a Community external surplus of that size. In that event, the accompanying economic policy would have to be less expansionary. Maintenance of the external balance at its initial level would then be consistent only with GDP growth of some 6,5 % (third line in Table 2) and the creation of some 4,4 million new jobs in the Community."

In the years between 1988 when the estimates and calculations of the Cecchini report was published and now in 2002 a profound change of official views on economic policies has taken place. This goes together with changes in the Treaty - foremost the Maastricht treaty - and enactment of the Stability and Growth Pact. In 1988 the Commission economists stated that macroeconomic policies, accompanying the internal market completion, are useful in supporting demand. They could be deployed without risking increased inflation or worsening budgetary or external balances by exploiting the room for manoeuvre created by the 1992 project. In the absence of common policies, there would be need to reinforce co-ordination. At present planning for co-ordination or common policies for the task of stabilising the macro economy is not significantly developed. Monetary policies are mainly relied upon for that purpose.

4. Disappointing follow-up of the Cecchini analysis

Then, what was the outcome of the completion of the internal market?

The average annual growth rate of GDP during the period 1992 to the end of 1997 was 1,5 % for the Euro area (1,7 % for all EU members). The period of

<table>
<thead>
<tr>
<th>Nature of economic policy</th>
<th>Room for manoeuvre used</th>
<th>Economic consequences</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GDP as %</td>
<td>Consumer prices as %</td>
</tr>
<tr>
<td>Without accompanying economic policy measures (from Table 1)</td>
<td>4,5</td>
<td>-6,1</td>
</tr>
<tr>
<td>With accompanying economic policy measures¹</td>
<td>Public finance</td>
<td>7,5</td>
</tr>
<tr>
<td></td>
<td>External position</td>
<td>6,5</td>
</tr>
<tr>
<td></td>
<td>Disinflation²</td>
<td>7,0</td>
</tr>
</tbody>
</table>

Margin of error: ± 30 %

1 The accompanying economic policy (public investment and reduction in direct taxation) is such that the room for manoeuvre created by completion of the internal market in respect of the public finance position (or in respect of the external balance or prices) is fully explained

2 It has been assumed, in this case, that the accompanying economic policy is so arranged as to exploit 30 % of the room for manoeuvre created by the fall in consumer prices. Full use of that room for manoeuvre would give unrealistic results (sharp deterioration in the external balance in particular).

six years practically corresponded to what was called the medium term in the analysis and model simulations. Even without "the accompanying economic measures" the addition to growth from the completion of the internal market was estimated to be about 0,7 % annually. With the estimate chosen (line 3 in table 2) in the case of partial exploitation of the new room for manoeuvre it would have been 1,1 % annually. This confrontation of forecast with actual performance indicates that the basic growth rate fell instead of rise. What had happened?

The most important factor for the explanation was the very restrictive monetary policies, the convergence discipline exercised by the EMS, the Bundesbank, EMI and ECB. This was undertaken during the 1990´ies in order to fulfil the price stability target and create a permanent credibility for that target. Another factor was the big change and enormous financial burdens connected with the reunification of Germany. The annual German GDP growth rate for the six years was 1,2 %, clearly below the EU average. So there was no accompanying expansive fiscal policy, but rather a prolonged drive for demand restrictions during the period we are dealing with here.

Where are then the beneficial effects of the creation of the internal market? It is obvious that most of the expected structural changes have become reality. Partly, their effects were probably postponed and would appear later. During the next 3 years - 1998 to 2000 - the GDP of the EU grew by 3,0 % as an annual average. The long upswing period of the US economy was a contributing factor for that and with the creation of the Euro area the initial depreciation of the Euro against the Dollar supported European net exports.

When evaluating the macroeconomic performance during the 1990´ies one should keep in mind the signs of a stronger technological advance, connected especially with the IT and communication sectors. The observations of the "the new economy" were discussed. In the USA the trend for labour productivity was rising. The US economy had during the later part of its long upswing remarkably few inflationary pressures although the unemployment rates were sinking. The balance point between inflation and economic growth (NAIRU etc) was changing. In Europe the new technologies were also observed, but were absorbed at a more modest scale. A key factor in USA might have been that a higher input of advanced education and technical competence was reached to match and complement the modern electronic and communication devices and software. The European economy may well follow up the track in the next few years and imitate the US performance in the late 1990´ies. To a significant extent such a development may be adopted by the European enterprises in old and new (candidate) member countries in the enlargement process.

There is no evidence that the forecasts regarding structural changes have been wrong. The recessive mood of the European economy has turned away part of the benefits from the consumers and citizens. As in every recession the creation of new business activities and investments were relatively low, lagging behind job destruction in other areas.

The EU economy is still suffering from insufficient utilisation of productive resources, foremost regarding labour. When the growth rate path can be lifted in the middle and long term with accompanying increases of employment the beneficial effects of the 1992 programme will materialise openly.

5. Structural changes following the enlargement efforts

Effects of economic integration between the EU and the applicant countries resemble those connected with the completion of the internal market from 1992 and onwards. From a welfare point of view there are both positive and negative effects, the former being dominant if the process runs according to plans and expectations.

For industrial goods the European agreements have created a free trade zone within a system of rules with supervision and checks. The mutual trade has increased considerably. The EU has become the main trading partner of the countries in question. The largest shares of trade with the EU have been reached by Slovakia, the Czech republic and Hungary, Lithuania having the lowest share. Among EU members Germany, Italy, France and Austria are the most important trading partners.

Trade with agricultural goods has been liberalised only partly. The liberalisation will continue stepwise and thus increase the share of agricultural products meeting free trade under normal CAP conditions.

Direct investments from EU into the candidate countries increased considerably during the 1990´ies, Poland, Hungary and the Czech republic receiving the largest flows. The FDI flows have an impact on supply of real capital as well as on technology transfer. The latter is also supported by trade in machinery, equipment and various types of software.

The requirements for economic transformation put the applicant countries have included rules regarding
the feasibility and operation of exchange rate systems. Systems with flexible exchange rates, for instance managed floating have become increasingly important.

It is important to note that free movement of services between the parties has been held back, mostly because of hesitation of related movements of persons and employees.

The progress in the field of customs tariffs and non-tariff barriers, capital movements and harmonisation of product rules and other things have certainly had a considerable impact on relative costs, prices and on the competitive climate that most enterprises in the candidate countries and in the relevant sectors of the EU economy meet. The rate of structural change and transformation is now higher and will continue to grow. The so-called supply effects due to opening of new markets, new competitors, more business opportunities as the reorientation of marketing takes place will probably play the largest role for economic progress also in this case, as it did in the 1992 programme for completion of the internal market.

All parties concerned will meet the challenge to release the possible gains in productivity and business opportunities, but also to assist in troubled branches and regions, which belong to losing parties in the process.

The EU is meeting some major problems in connection with the enlargement process, namely as regards the Common Agricultural Policy, Structural and Regional policies and free movements of persons.

Also the continued pursuance of the EU environmental policies and principles raises a significant problem. Reforms are needed in order to set limits to expenditure burdens of the EU budget and still maintain sustainable policies in the field of CAP, regional/structural policies and environmental protection. Regarding the free movements of persons and trade in services the EU members tend to defend rather long transition periods. These problematic complexes will be handled during or preferably in advance of crucial real membership negotiations.

The European Union will also have to tackle intricate reform issues regarding the major institutions, i.e. the Commission, the Council, the European Parliament and other bodies.

One lesson from the recent history is that the great transformation process, connected with the EU enlargement, will yield benefits at large scale dependent upon successful management of national and possibly co-ordinated macro policies. Without high growth, increased employment, increased investment, absorption of new technology and generally greater efforts for developing the human capital the enlargement may not seem worthwhile in the economic perspective to the extent expected.

References:


---

| Tab. 3: GDP in the OECD area; Annual growth rates, constant price, percent change |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| USA       | -0.5| 3.1 | 2.7 | 4.0 | 2.7 | 3.6 | 4.4 | 4.3 | 4.1 | 3.8 | 0.3 | 2.3 | 3.1 | 3.7 |   |   |
| Japan     | 3.1 | 0.9 | 0.3 | 1.1 | 1.5 | 3.6 | 1.8 | -1.0 | 0.7 | 2.2 | -0.5 | -0.2 | 1.0 | 1.4 |   |   |
| Germany   | -1.8 | -1.1 | 2.4 | 1.8 | 0.8 | 1.5 | 1.7 | 3.2 | 0.7 | 0.7 | 0.7 | 2.4 |   |   |   |   |
| France    | 1.0 | 1.3 | -0.9 | 1.9 | 1.8 | 1.1 | 1.9 | 3.5 | 3.2 | 4.2 | 1.8 | 1.3 | 2.8 |   |   |
| United Kingdom | -1.2 | 0.2 | 2.5 | 4.6 | 2.9 | 2.6 | 3.4 | 2.9 | 2.4 | 3.1 | 1.9 | 1.8 | 2.8 |   |   |
| Italy     | 1.4 | 0.8 | -0.9 | 2.2 | 2.9 | 1.1 | 2.0 | 1.8 | 1.6 | 2.9 | 1.8 | 0.8 | 2.4 | 2.5 |   |   |
| Canada    | -2.1 | 0.9 | 2.3 | 4.8 | 2.8 | 1.6 | 4.2 | 4.1 | 5.4 | 4.5 | 1.5 | 3.2 | 3.6 | 3.4 |   |   |
| Belgium   | 1.8 | 1.5 | -1.0 | 3.2 | 2.5 | 1.2 | 3.6 | 2.3 | 3.0 | 4.0 | 1.0 | 1.1 | 2.6 | 2.7 |   |   |
| The Netherlands | 2.5 | 1.7 | -0.9 | 2.6 | 3.0 | 3.0 | 3.8 | 4.4 | 3.7 | 3.5 | 1.1 | 0.8 | 2.6 | 2.9 |   |   |
| Schweiz   | -0.6 | -0.2 | -0.3 | 0.3 | 0.6 | 0.3 | 1.7 | 2.4 | 1.6 | 3.0 | 1.3 | 0.8 | 2.1 | 2.7 |   |   |
| Austria   | 3.3 | 2.4 | 0.3 | 2.7 | 1.7 | 1.8 | 1.7 | 3.5 | 2.7 | 3.3 | 0.8 | 0.9 | 2.7 | 2.9 |   |   |
| Spain     | 2.5 | 0.9 | -1.0 | 2.4 | 2.8 | 2.4 | 4.0 | 4.3 | 4.1 | 4.7 | 2.8 | 2.1 | 2.9 | 3.1 |   |   |
| Denmark   | 1.1 | 0.6 | 0.0 | 5.5 | 2.8 | 2.5 | 3.0 | 2.5 | 2.3 | 3.0 | 1.0 | 1.5 | 2.3 | 2.2 |   |   |
| Finland   | -6.3 | -3.3 | -1.2 | 4.0 | 3.8 | 4.0 | 6.3 | 5.3 | 4.1 | 5.6 | 0.7 | 1.1 | 3.3 | 3.3 |   |   |
| Norway    | 2.6 | 3.3 | 2.7 | 5.1 | 3.8 | 5.3 | 4.5 | 2.4 | 2.9 | 2.3 | 1.5 | 1.8 | 2.4 | 2.2 |   |   |
| Sweden    | -1.1 | -1.7 | -1.8 | 4.1 | 3.7 | 3.7 | 2.1 | 3.6 | 4.5 | 3.6 | 1.2 | 1.9 | 2.7 | 2.4 |   |   |
| Euro area | 2.6 | 1.5 | -0.8 | 2.3 | 2.2 | 1.4 | 2.4 | 2.9 | 2.7 | 3.5 | 1.5 | 1.1 | 2.6 | 2.7 |   |   |
| EU        | 1.9 | 1.2 | -0.3 | 2.7 | 2.5 | 1.7 | 2.6 | 2.9 | 2.7 | 3.5 | 1.6 | 1.2 | 2.7 | 2.7 |   |   |
| OECD      | 1.2 | 2.1 | 1.4 | 3.2 | 2.5 | 3.1 | 3.5 | 2.7 | 3.2 | 3.8 | 0.7 | 1.7 | 2.8 | 3.1 |   |   |

* = Forecasts

Source: Swedish National Institute for Economic Research, August 2002, Stockholm
Enlargement and Cohesion: a Reform of the Objectives and Funds

Hermann Bömer, Andreas Borchardt, Wolfgang Schlegel

1. Introduction: national and regional disparities

The Europe of today is a continent with a heterogeneous variety of countries, cultures and people. This diversity represents a major resource but is also manifested in regional disparities - particularly in economic terms. This is true for the current EU15, but is even more apparent in the perspective of the future enlargement of the EU. Ten additional members of the CEEC are expected to join in 2004 and another three aim to enter in the long run.

With its Cohesion Policy, the EU aims to reduce disparities "in order to promote its overall harmonious development" (EC Treaty, Article 158 (A)). Therefore a wide variety of instruments has been created. Some are explicitly linked to the Cohesion Policy, for example, the Structural Policy with its funds, while others - like the increasing economic integration - are part of an overall neoliberal approach hoping to reduce disparities through the balancing mechanisms of the market.

There are two main indicators used for measuring the progress of the EU Cohesion Policy: levels of GDP per capita and rates of unemployment. A character of this policy is furthermore the aim of convergence - the reduction of disparities in terms of an indicator value of zero (cf. Axt 2001: 21-23).

Investigating into the development of these two indicators of national and regional convergence within the current EU15 creates a nonuniform result. Measured in GDP per capita, there are some positive developments to be assessed. On a national level, the Cohesion Countries were able to narrow the gap, Ireland particularly performed very well during the 90's and has achieved a level above the EU15 average. The Cohesion Policy was not as successful on the regional level. Comparing the top 10% (in population) to the bottom 10%, the first rose from 55% of the EU15 average to 61%, while the top 10% rose from 155% to 161%. The lower gap narrowed, while the top got further away. Looking at intranational disparities, there is a significant number of countries with a widening gap in regards to GDP per capita. Only in some have disparities slightly narrowed (cf. European Commission 2001: 3pp). Figure 2 depicts the significant existing disparities:

Looking at the unemployment indicator gives a worse picture. Despite an overall trend towards more employment during the 90's and declining rates of unemployment, the regional disparities are widening. While the best regions (taking those accounting for 10% of total population) have unemployment rates around 3%, the worse hit regions bear rates averaging 23%, which is, however, much higher than, for example, 25 years ago (cf. European Commission 2001: 17).
Considering the approximate 185 billion € which went through the Structural Funds from 1994 to 1999, including the Community Initiatives, the results are rather disappointing. A lack of efficiency has to be recognised.

Investigating the Objectives and Community Initiatives, it is obvious that, in one regard or another, nearly every region is eligible for some form of funding. Especially the former Objectives 3 and 4 regions (today condensed to Objective 3) are by definition non spatial, covering all regions out of Objective 1. Furthermore, the eligibility criteria are only partially defined. Best known is the 75% GDP per capita criterion for the Objective 1 regions. In comparison, the Objective 2 regions are more or less negotiated between the member states and the European Commission.

But also the distribution of funds between the member states is in most parts negotiated. As a consequence, the highest funding per capita in Objective 3 and 4, for example, was held by the Netherlands, despite the fact of having the lowest unemployment rates (cf. Axt 2000: 224). The overall impression is that all member states try to maximise their national share of means, while those better off search for ways to ensure some minimum backflow. The best example being the introduction of the Objective 6 at the accession of Finland and Sweden. As a consequence, the efficiency is reduced. In the perspective of the upcoming challenges resulting from the enlargement, these deficiencies can not be accepted any longer. Unfortunately, the changes made by the Agenda 2000 are insufficient. The aim to concentrate the means is only written on paper (by reducing the Objectives from six to three) rather than implemented in reality (nearly everything is subsidized as before).

In the rest of the paper we propose an alternative approach to regional development. Our propositions are divided into three sections. In the first part, the authors propose a reform of the existing system of funds and objectives, by more strictly defining the criteria. In the second part, these ideas are complemented by the extension of the current system with environmental and cultural objectives seen necessary for sustainable development in Europe. Finally, a completely different approach, based on an income compensation system will be discussed.

The specific figures proposed are not calculated but roughly estimated to indicate the directions and relative dimensions of changes considered. This is accredited to the fact that this paper aims to initiate a general discussion about an alternative structure of the future regional policy.

2. Reform of Objectives and the Organisation of Funds

The major aim of the proposed reform is to concentrate on less developed regions. However, a more transparent organisation of funding is also necessary. The separation of different funds is especially confusing and should be abandoned. This is possible by putting the structurally effective funds together under one heading. In the end, there should be no longer four different Structural Funds but only one, which finances all structurally effective measures.

Thinking about concentration of means itself, Community Initiatives, Cohesion Fund, and Objectives are to be considered. In regards to the first, the Community Initiative Equal should be cancelled because of its lack of concentrated regional effect. Also, the necessity of the Community Initiative Urban has to be thought over. It is regularly criticised as being in opposition to the subsidiarity principle - therefore European engagement is unnecessary.

Looking at the Objectives and their eligibility criteria we propose three distinguished New Objectives or rather regions defined by these objectives. The eligibility criteria of the New Objectives for structural funding are going to be solid criteria and political interference will be unlikely to succeed. The proposed New Objectives are described in table 1. These New Objectives are going along with the demand to increase the overall means under the perspective of the forthcoming enlargement. The authors agree with the Arbeitsgruppe Alternative Wirtschaftspolitik, which suggested to have 5% of

<table>
<thead>
<tr>
<th>Tab. 1: New Objectives within the existing framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Objective 1</td>
</tr>
<tr>
<td>NUTS II regions whose</td>
</tr>
<tr>
<td>• GDP (per capita) is less than 65% of Community average or</td>
</tr>
<tr>
<td>• unemployment rate is more than double of Community average</td>
</tr>
<tr>
<td>NUTS III regions whose</td>
</tr>
<tr>
<td>• GDP (per capita) is less than 65% of Community average or</td>
</tr>
<tr>
<td>• unemployment rate is above Community average</td>
</tr>
<tr>
<td>New Objective 2</td>
</tr>
<tr>
<td>NUTS III regions with</td>
</tr>
<tr>
<td>• Continuously decreasing GDP (per capita), which lead to a GDP under Community average or</td>
</tr>
<tr>
<td>• Continuing increasing unemployment rate which lead to a unemployment rate over Community average</td>
</tr>
</tbody>
</table>

Source: Own Layout
the member states’ GDP allocated to the disposition of the EU (cf. 2001: 10). This creates the opportunity to substantially increase the means for regional development. Analogous to the previous financial perspectives where the budget of the Structural Funds was roughly doubled each time, the authors propose a similar extension. In consideration of the challenges of the future enlargement of the EU 15, this amount seems very reasonable.

Spatially, the New Objectives are supposed to have the following distributional effects: New Objective 1 is created in particular for the regions in the CEECs, while New Objective 2 is meant to support the former Objective 1 regions of the EU15. Former Objective 2 regions are likely to phase out of funding, unless they are eligible for the New Objective 3.

Concentrating the support on the most needy regions, the New Objective 1 should get a share of 70% of the means of the New Structural Fund, while New Objective 2 should receive 15%, and New Objective 3 10% - the rest is given to the Community Initiatives. A contribution of 15% own finances seems realistic, looking at the situation in the Candidate Countries. This is for New Objective 1, while New Objective 2 should have its own financial share of 40%, and New Objective 3 of 70%. This percentage ensures that all regions are able to apply for European funding, even if their budget is low.

The funding facts of the Cohesion Fund might be integrated into the New Objectives and could be consequently abolished. Also, the spatially effective parts of agriculture policy - the second pillar of the CAP and the EAGGF Guidance Section - might be integrated in the New Structural Fund.

3. The importance to include additional objectives

The current Cohesion Policy with the central indicators GDP and unemployment is aimed at economic and social cohesion. With the exception of the Cohesion Fund, environmental aspects are not integral parts of the Cohesion Policy, even more so with regards to cultural aspects. These are usually regarded as an exclusively national or even regional matter. However, in the sense of a sustainable development, the authors would like to propose two new additional objectives: a New Objective E(nvironment) and a New Objective C(ulture), which extend the actual framework.

New Objective E should be divided in three sections which are responsible for three general cases of environmental quality (Table 2). In every one of these three cases, two specific difficulties are to be addressed. On the one hand there is the relative environmental efficiency in regards to resources used for production. One example might be the output of goods of a region set in relation to its output of harmful substances (e.g.: tons of CO2 per tons of good).

On the other hand, the absolute state of the environment in regards to environmental degradation has to be addressed. Examples could be the levels of air or water pollution but also the degree of soil consumption.

Also New Objective C is divided in three categories (Table 3). The first imaginable criterion for a category is the supply of cultural institutions as theatres, cinemas, museums, etc. Regions eligible in this sector of Objective C have to use the financial support for the development of their cultural infrastructure. A second criterion for Objective C funding is the stock of cultural heritage. To maintain the high cultural quality of regions with important cultural heritage it seems sensible to give financial support. The third criterion applicable for Objective C funding is social bonds. The measurement of this criterion creates problems. Possible indicators could be the density of associations, societies and clubs, the incidence of single parent families, family size, etc. Social bonds are an important part of social cohesion.

<table>
<thead>
<tr>
<th>Definition</th>
<th>Eligibility Criteria</th>
<th>Spatial effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regions with a serious lack of ecological efficiency and a poor state of environment</td>
<td>Regions eligible whose: 1. Ecological efficiency is under 75% of EU average 2. Pollution of one natural element is more than 125% of EU average</td>
<td>Mostly old industrial regions which are still in the process of structural adjustment and regions in the new member states will be eligible for this kind of funding</td>
</tr>
<tr>
<td>Regions which are lagging behind in the environmental sector</td>
<td>Regions eligible whose: 3. Ecological efficiency is under 85% of EU average 4. Pollution of one natural element is more than 115% of EU average</td>
<td>Old industrial regions and regions with agricultural tradition will be eligible for this category of funding</td>
</tr>
<tr>
<td>Regions which tend to fall back in the environmental sector</td>
<td>Regions eligible whose: 5. Ecological efficiency has fallen back more than 5% within the last three years 6. Pollution of one natural element increased more than 5%</td>
<td>Regions which invested less in their environmental quality or regions with a high growth in short terms are the main receivers of this funding category</td>
</tr>
</tbody>
</table>

Tab. 2: New Objective E and its subdivisions

Source: Own Layout
Therefore, measures to protect and/or support social bonds should be financed.

The New Objectives E and C are each receiving 50% of the total amount of funds provided for regional development, in order to show the importance of these objectives. The proportion of support given by the EU should depend on the economic situation of the region. Economically less-developed regions receive more support, economically higher-developed regions get less support. At this point, a connection to the Structural Policy becomes suggestive. As a consequence, the financing rates are oriented on those of the New Structural Fund: New Objective 1 regions have to invest 15% on their own and New Objective 2 and 3 regions 40%. In order to stimulate activity all over Europe, other regions complying with the criteria are to be co-financed by 30%.

4. Functional division of regions

The third proposal is breaking completely with the existing framework. Through its focus to promote economic growth in order to increase economic and social cohesion, the actual framework is in opposition to ecologic necessities. Of course, the measures proposed beforehand could fundamentally improve the current system. Nevertheless, the impression of an "end of the pipe" solution, aiming to limit the negative effects indicated by economic development, is obvious.

One central idea is to replace the indicator GDP by income. Many markets in the EU are saturated already. Therefore cohesion is not a matter of additional production, but of a better distribution of the existing output. For the people of a region, it is not important where products and services are produced, but that they are able to take share in their consumption. Furthermore it is crucial to have the people engaged with something of value.

The approach chosen is completely contrary to the traditional framework of regional development. At its basis is a spatial division of functions: while some regions are centres of production, others could fulfil an agricultural, recreational, ecological or even cultural function. But as long as income is highly correlated with economic output, such functional divisions are not likely to work out, because the existing gaps of prosperity between central/industrial and peripheral/agricultural regions remain. Consequently a regional compensation system is necessary. This has to be based on regional income on the one hand and on the regional function on the other hand. But not only the Structural Policy has to be part of this proposal. The CAP is also to be integrated into the new income based regional compensation system.

The European Spatial Development Perspective

<table>
<thead>
<tr>
<th>Definition</th>
<th>Eligibility Criteria</th>
<th>Spatial effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regions with a lack of cultural infrastructure or with a negative tendency in the field of cultural infrastructure (prevention)</td>
<td>Regions eligible whose: 1. Density of cultural facilities is under 85% of EU average 2. Density of cultural facilities has decreased by more than 10% within three years (prevention)</td>
<td>Mainly old industrial regions and rural areas will benefit from this category</td>
</tr>
<tr>
<td>Regions with a high stock of cultural heritage</td>
<td>Regions eligible whose stock with cultural heritage is 20% over EU average</td>
<td>Regions with great importance for history (for example in the Mediterranean) will benefit from this category</td>
</tr>
<tr>
<td>Regions with a lack of social bonds or are falling back in the field of social bonds (prevention)</td>
<td>Regions eligible whose: 3. Supply with facilities supporting social bonds is less than 80% of EU average 4. Value of one of the family indicators is worse than 85% of EU average 5. Indicators in the definition of the status quo criteria have been decreasing more than 10% within three years</td>
<td>Many regions will benefit from this category, old industrial regions with a high degree of individualisation as much as the Southern European countries where social bonds are decreasing at the moment</td>
</tr>
</tbody>
</table>

Source: Own Layout

<table>
<thead>
<tr>
<th>Function</th>
<th>Objectives</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic</td>
<td>Production of goods and services</td>
<td>&quot;The blue banana&quot;,…</td>
</tr>
<tr>
<td>Ecologic</td>
<td>Protection of fauna, flora and natural resources</td>
<td>FFH-areas,…</td>
</tr>
<tr>
<td>Agricultural</td>
<td>Provision of sustainably grown agricultural products</td>
<td>Magdeburger Börde, Champagne,…</td>
</tr>
<tr>
<td>Recreational</td>
<td>Provision of space for recreation and respective facilities</td>
<td>Costa del Sol, Mallorca,…</td>
</tr>
<tr>
<td>Cultural</td>
<td>Preservation of historical customs, architecture or landscapes</td>
<td>Rome, Tuscany, Spreewald,…</td>
</tr>
</tbody>
</table>

Source: Own Layout
could become the central document defining and coordinating the spatial functions (Table 4). The functions possibly considered are outlined in the table above. Thereby every region is able to acquire only one function at a time. Consequently, financial support is only to be acquired for the respective objective.

The current system intends to abolish itself by aiming to help regions out of the eligibility criteria. The compensation system, on the other hand, allows for a continuous need for compensation. An ecological region will probably never be able to support its citizens autonomously with goods of consumption. Therefore it provides the European society with an ecological service and is paid respectively. However, the concentration on one function does not mean one region is absolutely committed to this single function. Positive side effects to other functions are explicitly desired - as long as they are based on the regional function. One example: In an ecological region, a new plant is not eligible for funding by the compensation system. It might be funded privately, but no support is to be received. However, if this plant is in support of the ecological objective, funding might be obtained also for an economic investment.7

To classify different regions into functions, a system of objective criteria might be considered. However, a solution by negotiation appears preferable. As a prerequisite, the compensation system can not favour some functions over others. Otherwise every region would just desire to be one of the regions with maximum support. The guarantee for this must be the compensation system itself. Providing comparable living conditions by comparable income levels over all spatial functions, every region is free to decide what suits best to its regional situation and is not under pressure by economic considerations.

The aim has to be a non-discriminating redistribution of income. Yet, the amount to which compensation is put into place is difficult to define. Godfather might be the Cohesion Fund. In this situation, an eligibility criteria of less than 90% from the average GDP is set to qualify for assistance. But instead of using GDP, the regional income becomes accountable for the proposed compensation system. Considering the desired redistributional effect, an accompanied maximum has to be set up as well. In order to spread the burden as much as possible all regions with an income level of 100% (of the average income) or more are proposed as contributors. Consequently, regions with higher incomes have to redistribute in favour of those with a lower income level.

Operationally, the higher incomes could be drawn by taxes on income whereas all kinds of income are to be considered, not just income derived from labour, but also profits from business, capital or the like. In regions with a low level of income, two criteria are to be followed by the distribution of the money raised: First, the distribution of additional income has to focus on those with already low incomes, particularly unemployed. Second, the income has to be distributed in consideration of the specific function. To guarantee the effect for regional income and employment, a minimum of 80% has to be spent on labour. Also co-financing of jobs is imaginable. This means a very direct increase of personal income levels. The remaining 20% might be used for tools or infrastructure necessary for the primary projects.

The regional distribution of the money itself should remain a regional task in correspondence with the subsidiarity principle. They might spend the money on programmes and projects, or they might prefer to pay subsidies to companies or improve the incomes by direct transfers. The particular arrangements are part of regional creativity and competition. Continuing the programming as it is today would require an exhaustive administration. The national institutions will have the task to control whether the expenditures comply with the aforementioned criteria and functions, while the European institutions are responsible for overall strategy matters and coordination.

Essential for a real reform - independent from its layout - remains the willingness of everybody involved to share with those who are most in need. Considering the huge disparities between the current EU15 and the CEECs, it becomes clear that the focus of action has to move towards the East. There lies the major challenge for economic and social cohesion in the future. Measures have to be taken accordingly.
References:


---

1 This paper for the second meeting of the Thematic Network: “Improvement of Economic Policy Coordination for Full Employment and Social Cohesion in Europe” is the result of a deepening student project (Vertiefungsentwurf) which is a compulsory part of the final degree at the Faculty of Spatial Planning at the University of Dortmund. The original report of about 60 pages, worked out by Andreas Borchardt, Torsten Licht and Wolfgang Schlegel under the supervision of Dr. Hermann Bömer (Department of Political Economy) and Dipl.-Ing. Andreas Freundt (Department of European Spatial Planning) is published as a working paper under the title “The Cohesion Aim and the European Union - An Alternative Policy for Regional Development” and available at: http://irpud.raumplanung.uni-dortmund.de/irpud/pub3.htm#arbp. A printed version of the report can be ordered at: Bereich Dokumentation, IRPUD, Universität Dortmund, 44221 Dortmund, Germany, Tel.: (+49) 231 755 2215, Fax: (+49) 231 755 4788, E-mail: doku@irpud.rp.uni-dortmund.de

2 First group: Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia; second group: Bulgaria, Romania and Turkey

3 Not to be mistaken with the term of convergence defining the criteria to join the Monetary Union!

4 Greece, Ireland, Portugal and Spain

5 The long version of this paper also makes proposals for an institutional reform which is seen as a necessary stipulation for the actual reforms.

6 During the discussion of this paper at the 2nd EPOC meeting it was suggested to consider also the support of social facilities similar to cultural infrastructure. The argument was that particularly social infrastructure is a very visible engagement of the EU for the people concerned locally and therefore worth funding. As a consequence also a New Objective S(social) could be developed.

7 It is not intended to create a system of regions with rigorously divided functions implying an increased effort for transport. On the contrary. Costs of transportation are to be increased in order to promote regional production of essential commodities and products with a low added value in comparison to their weight. For more details on this complex see the long version of this paper.

8 The existing regions defined in NUTS are hardly able to be used. The outlines vary too much in order to be compareable. Therefore a more hamonious definition of the regional level has to take place. For more details on this complex see also the long version of this paper.
Part 2:
Country specific Issues of Enlargement

Accession to EU - yesterday, today, tomorrow
T. Kowalik

Economic and social development in Slovakia after 1989 and accession to the EU: Development trends and transformation cycles
I. Okáli, M. Sikula

Slovenia: Alternative Economic Policies in Action
J. Mencinger

The accession of the GDR to the Federal Republic - the first step to eastward expansion of the EU?
K. Steinitz

The Hungarian way to the European Union
L. Andor
Accession to the European Union – Yesterday, Today, Tomorrow

1. Fundamental Questions

I want to dedicate this paper to a couple of the most general systemic problems, that are important from the point of view of Poland’s (and other Central European Countries’) accession to the European Union. Among the ten candidates Poland is the biggest country and for that reason alone the problems it faces are on a much larger scale than those in the other countries. Integration is first of all an integration of societies, and Poland alone has a greater population than the other nine candidates combined, along with the highest unemployment rate. Therefore Poland deserves special attention. It is not meaningless that the great systemic changes at the end (and also the beginning) of the 80s, started here, appointing Poland – at least for a certain time – as a pioneer and example for others to follow.

One should keep in mind three main questions (to which I will return at the end of this paper) when analysing the history of the Union up to now; its current economic policy and the socio-economic problems facing Poland: (a) Does the official policy of the EU, up till now, promise to solve the main social problems of Poland?, (b) if not, what are the chances that this policy will change? and (c) if this does not occur can Poland, as a member of the EU, being in the extraordinary situation which it finds itself, count on the understanding and acceptance of its own, socio-economic policy, diverging from the rules of the EU?

2. Promised and real benefits

Poland’s negotiations with the EU are commencing with the held assumption that its general economic policies are given. Even the proclaimed changes in the CAP would be hard to claim as fundamental. Not only Polish negotiators, but also academic participants in the dispute, (with a few exceptions, which will be mentioned below), avoid raising the main principles of this policy, such as the Maastricht Treaty, or the Amsterdam Pact on Stabilisation and Growth. Moreover it is sometimes alleged, unfortunately not without reason, that the negotiations take place with the candidates “on its knees”. What kind of negotiations are these if, from the very beginning, it is known that the final result cannot be a “non-accession”. It is said that the only other alternative is that of “Belarus” (or the Belarus Station, as it is called by the former representative of the left wing of the SLD, MP Sierakowska, which looks like a mutation of the slogan “socialism or barbarity”). As an answer to the question what is the line that shall not be crossed in compromising in the negotiations with the EU, or at what point we should be forced to say non possimus, a former negotiator (otherwise an enlightened person) Jan Kulakowski (2002) uses an over-sophisticated argument. He says “cardinal Wyszynski talked about non possimus when the communists ruled. Now there is a different problem, a different aspect. Now there cannot be any non possimus” (“Rzeczpospolita”, 21.06.2002).

First let us analyse the expected benefits for Poland upon its accession to the EU, as this moment seems now to be close. Amongst some of the banal statements there is one that the expansion of the EU to the East is an exceptional case. The main problem is that these countries are only just creating a new market and their corresponding institutions, they lack experience in competing on international markets, they have poorly developed and inexperienced legal and trade structures and in general their entrepreneurs can be characterised as very weak. If we consider post communist countries, except Slovenia and the Czech Republic, we can also see that they are on a lower, and some of them on a much lower, level of development than countries such as Greece, Spain, Portugal and Ireland. We may call these countries as “supported” as opposed to “supporting” countries, that is those, whose financial contributions to the EU budget are greater than what they take from it.

This topic was discussed by the authors of the book Not ‘just another accession’ (Eatwell et al. 1997) who are involved with the social democratic fraction of the EU. For these Western authors it was obvious, that new candidates need greater assistance before as well as after their accession. In addition they also need a longer transition time. Although this book was translated and published in Poland, by Wydawnictwo Sejmowe (Parliamentary Publisher), it did not raise much interest amongst Polish MPs. It seemed to me, that they thought that what has to be explained to the western reader is obvious for Poles. What a different situation we have only five years later! New candidates, especially Poles, would be happy if the West would treat them “as any other
accession”, that is if they were accepted on similar conditions to those, which were guaranteed to the ‘supported’ countries. Incredibly it is not even clear that the new candidates will have to “give” more than they will “get” from the EU, despite recent statements by EU functionaries trying to dispel these doubts. Therefore it must be accepted, that it will not be an “accession, like others”, and assistance will not be expanded, but diminished. Therefore it is especially worth taking a look at the results of earlier accessions.

It is said that the entrance of Poland into the EU will mean the widening of the area of expansion (a great common market) and transfer of structural funds, which are to raise the GDP per capita to a level of 75% of that of the EU and raise to this level the per capita income of the country’s underdeveloped regions. This is exactly the main idea of Guenter Verheugen (2002), when he sums up the “union benefits” in the following sentences: “Membership in the EU gives unlimited access to the biggest consumption market in the world; a great common market creates economic dynamism – along with growth and more workplaces (...) /and also converging living standard in a unified Europe, through identifying areas with worse economic conditions and investing in these areas on a great scale”.

To what extent, if at all, has this happened in countries that have been supported up to now? Has the policy of the EU managed to achieve the convergence of the less developed regions and countries? This is a question, which concerns the economic benefits that were gained by countries of southern Europe and Ireland. A study by Boldrin and Canova (2001) provides a thorough and deep answer to this question. Although the above study, and the discussion around it, concentrated mainly on the problem of regional convergence it also contributes to explanations about the problem of convergence in the supported economies in general. One of the discussants summarised the main thought of this study in the following words: “The main message of the paper is that European regional policy is based on a growth model that implies divergence and this model directly suggests that active intervention, mainly in the form of infrastructure investment, is needed to keep poor regions from falling even further behind. The authors (Boldrin and Canova - TK) conclude that there is little evidence that this model is true, and little evidence that the regional policies of the EU are effective. Instead, the basic inference from the data is that for the most part regions in Europe grow pretty much at the same rate, that is, neither convergence nor divergence seem to be taking place.”(Pischke 2001, s. 245)

Boldrin and Canova equally state that the study “suggests that, on average, uniform long-run growth rates are to be expected and relative differences will not disappear” (ibid. p241).

How should we understand the above-cited optimistic words of Verheugen? We can certainly not treat them as a summary of the Union’s efforts towards the convergence of regions, and we don’t see any sign of an attempt to revise the present policy.

The same discussant (Pischke) presents a graph illustrating the growth of GDP per capita in Greece, Portugal, Spain, Ireland and Turkey compared to the average 15 members of the EU. This part of the analysis provokes serious considerations. Portugal improved its status. Spain improved its position in the second half of the 80s, but in the first five years of the 90s this process of improvement stopped. Greece on the other hand was improving its status only after its accession to the EU, after which a weak regression occurred. All this can be contrasted with the early post war years, as the same author writes, when a “wonderful period took place, when the European economies were converging at an impressive rate of 2% annually” (ibid. 46). At that time all the three above-mentioned countries of southern Europe were catching up with the then more developed countries of EWG.

The only country, which as a member of the EU has made a significant economic leap is Ireland. However Ireland is an example of a country, that (before the restrictions from Maastricht were placed on it) started out with a highly interventionist economy, selectively supporting the most modern branches of manufacturing industries. In a certain sense it broke away from the dominating rules of the EU. In any case, virtually all economists treat the Irish case as being exceptional in many different respects.

The authors and discussants address to the EU authorities numerous troublesome questions. For example if these funds are to help achieve specific goals, but the goals are not met, maybe there are other reasons for the existence of these funds? And in their own words: “Why does the EU need to ‘bribe’ newcomers, by means of subsidies, when one should expect them to be willing to pay for joining a free trade area? Why do temporary transfers and support programmes become permanent when the apparent reason for their initial establishment does not exist any more?” (ibid. 244). The most troublesome question, however, touches the very foundations of
EU policies. Do these funds and aid programs compensate for the damages, which arise from the Maastricht Treaty and the Amsterdam Pact? It must be explained why the most significant convergence took place in Europe during the highly interventionist years of the 50s and 60’s. I conceive the warning, formulated by one of the leading German-American economists, Rudi Dornbush as touching this question. He writes, “Public finances in the EU are linked to the requirements of the Maastricht Treaty and by their means growth cannot be stimulated. If it should turn out that revival in the USA will not be quick and significant, soon Europe will regret the Maastricht decisions, which make counter-cyclical policy impossible. The tight Budget safety jacket from Maastricht, introduced to calm the fears of the German bond holder about a currency union, may now turn out to be a catastrophe” (Dornbush 2001). Although Dornbush narrowed this problem down to the matter of bonds, he accurately pointed to the key role of Germany in forming the foundations of the Maastricht Treaty.

Dornbusch found unexpected support from a range of finance ministers during their meeting (11.07.02) in Brussels. The „Financial Times“ informs that at this meeting (in Amsterdam) the Growth and Stability Pact was under heavy attack. Although the Maastricht treaty was not directly attacked, it is clear that the pact sets out details which emerge from the general principles of the Maastricht treaty. It is also obvious that anti-cyclical policies have an important influence on long term growth. The FT also points out that the main architect of the pact, ex German Finance Minister Theo Weigel, is becoming isolated. We can therefore say that the recent recession has meant that Keynesianism, after its rejection for many years, is now returning to favour. This is similar to what happened after the crisis in Asia.

Poland would therefore best be able to fulfil the dreams of Verheugen if her policy respected principles such as full employment; a decrease in poverty (which is especially important for Poland) and quickly engage themselves in the contentions surrounding the creation of an economic policy in the EU. Is it only during a protracted recession that the creation of an economic policy in the EU. Is it only during a protracted recession that the creation of an economic policy in the EU. Is it only during a protracted recession that the tight Budgetary policies have a negative effect on the economy? It is worth mentioning here the experience of the Italian region Mezzogiorno, which only closed the gap with the more developed North during the period of post-war interventionism. The return to the ‘Zeitgeist’ of the free market did not only bring this period of convergence to an end in Italy. In this light the EU financial transfers play not only the role of levelling out inequalities but also that of compensating for the negative effects caused by the free-market policies arising from the Maastricht treaty and later the Growth and Stability Pact. The above mentioned experiences and warnings of Dornbush bring for Poland, as an EU candidate burdened with huge and growing unemployment and an underdeveloped farming sector, a pessimistic outlook. Countries, which have belonged to the capitalist world, have not gained a great deal (if indeed they have at all) from the EU. For our country, with its separate tradition and huge social problems, significant resources are needed to survive the next shock without therapy after accession. Actually Poland has already included in its constitution the tight budgetary and monetary policies borrowed from the EU, acknowledging however that in an exceptional situation (high unemployment) they could be loosened for a strictly defined period of time. Inside the EU this possibility will no longer exist, unless there is an evolution of a friendly “democratic capitalism” in the EU and Central Europe, with the return of a social market form of capitalism. However the consequences of the latest stormy events are as yet unclear.

3. “Concerted Diversities”?

The above phrase is taken from an interview with Ulrich Beck (2002) who argues that globalisation and integration do not lead to uniformity but to a coordination of diversities in different spheres such as public finance and social policy. Is this true? And does the term expansion only relate to the current economic policy or also to different national socio-economic systems? And if so, what would be the range of co-ordination? Unfortunately we have to operate in this field blindfolded, as no groundwork of research exists on the topic. Partial research has been carried out concerning the past, but this is not instructive for the future. Most interesting would be an answer to the question, what and to what extent have the countries Austria, Sweden and Finland, whose economic systems and current economic policies differ from the other twelve nations, achieved after entry to the EU? It is however too early to say. Together with Holland, Denmark, Belgium and also partly France they create a strong group of European continental countries which are dominated by communitarianism. Perhaps the conclusion which can be drawn from this is that the organisational and institutional transformation research in the EU countries should become a priority in the research field for those countries aspiring to join the Union.
The most important case of a systemic change within the European countries is Germany, an economy (the largest in the Union) with a huge influence on the competitiveness of the region. To analyze this case would be tempting as the system in Germany is known as a Social Market Economy (the abbreviation SME will be used in this paper), and the fate of the German social market economy is of particular interest to Poland, which, in its constitution from 1997, committed itself to building an economic system based on the rules of this system. Let us try then to answer the question: is the German economy adopting the American way of business?

This question has two dimensions. The first one is whether the German socio-economic system is in the process of being dismantled in favour of the Anglo-Saxon system, that means whether the German authorities run such an economic policy (Ordnungspolitik) which reduces the differences between the German and Anglo-Saxon social orders? The second dimension contains current economic policy (what the Germans used to call Prozesspolitik). This distinction, however, has a more formal than real character, because when current economic policy is systematically and unequivocally based on a definite doctrine, for example on a laissez-faire or monetarist conviction, it creates a new reality of a systemic character. It seems that this has been the case with German economic policy for more than a decade. This is why it is worth starting with this dimension.

There have been many authors (H. Flassbeck (1999), F. Modigliani (1997), K. Aaski (2000)) who have criticised the German economic policy of the last decade. We can mention in particular the criticism concerning the minister of finance Theo Waigel and the Bundesbank, before the victory of the SPD, and Hans Eichel afterwards. Munchau, writing about Eichel’s reforms, claimed: “Mr Eichel’s package is a school-book example of what fiscal policy should not be like. At the time of high unemployment and slow economic growth, he chooses strict fiscal policy (...) It would make much more sense to do exactly the opposite. (Munchau 1999)”. His article ends with the ironic remark: Eichel’s predecessor (Lafontaine -TK) was not a reformer, either. At least, he understood the economy. The same could also have been said about Waigel’s policy, which was consistently procyclical. Critics have blamed German economic policy of the last decade for creating a low rate of growth and exceptionally high and permanent unemployment, which was particularly harmful when the economy was facing recession. Both are against the principles of SME: mass unemployment is against the rule of full employment whereas slow GDP growth makes the state unable to adequately meet employee’ and citizen’s entitlements. Thus there is little doubt that, by and large, the monetarist policy of the Bundesbank and the restrictive fiscal policy of subsequent finance ministers (with the exception of O. Lafontaine intermezzo) have strongly hit the very foundations of SME. One may only ask whether it was an expression of simple inconsistency or of a long-term goal of dismantling SME. There is a visible paradox that the American economy, which has the least developed welfare state, was in the 1990s closer to the idea of full employment than Germany, with its SME, due to a better economic policy.

So far, the more or less deliberate resignation from a full employment policy is the most important step back from SME. Two other changes seem to be moving in the same direction: abolition of a special tax on bigger shares packages2, regarded as a barrier against hostile buys of German corporations, and an introduction (rather modest compared with the Polish 1999 reform) of a capital pillar to the pension system. The first one was highly prized by American business (“Wall Street Journal”) as a great leap forward towards a free market economy “Schroeder and Eichel managed to launch free market mechanisms without attracting attention. Therefore, it seems that the policy of the current government is better for entrepreneurs than the policy of the former Chancellor Helmut Kohl” (Roth, 2000). There is therefore no doubt that the neo-American system is progressing in Germany.

Some of the authors seem to believe that Germany has already travelled quite far down this and that die soziale Marktwirtschaft practically belongs to the past. Things however are not so clear. More than a decade ago Michel Albert (1991/1994), an adamant supporter of the German social market economy, regretted that the „Rhine model” is giving way to the ‘neo-American model’, although in his opinion it was more just and effective than the American one. Simultaneously, however, he envisaged a dramatic struggle between the „Rhine” (i.e. West German) system and the neo-American one: “It will be an underground war, violent, obstinate, but partly hidden or even full of hypocrisy, just as any internal struggle within any one Church is full of hypocrisy. A struggle between brothers armed with two models (...) carrying two antagonistic kinds of logic within the same liberalism. And perhaps (...) two systems of values...” (26)’. This struggle is still very far from being accomplished, with the roots of the systemic differences lying in the different philosophies of the
German and Anglo-Saxon societies. This is at least the conclusion of a thorough study by the American scholars J. D. Morrison and R. A. Wolf (1999/2000), who conclude with the following main observations.

- For the Germans, the welfare state (“Wohlfahrtstaat”) is an outcome of a tacit social agreement between the government and its citizens. Social aid is not only accepted, but also expected. Most social services are rights, regardless of their cost and the income of a particular family. The state is obliged to build a social network for the common good. Communitarianism prevails over individualism, in contrast to the United States, where people on welfare are seen as losers and there is a strong tendency to condemn them. The state is perceived as an inevitable evil and the expenses on maintaining the state – as a threat to individual freedom. The authors quote one of the recurring themes of Bob Dole’s pre-election speeches: The scariest words in the English language are ‘I’m from the federal government and I’m here to help you.’ It is hard to imagine a European politician, even an extremely conservative one, who would use this sentence as his electoral slogan.

- Differences consist not only in the level of material aid aimed at reducing poverty and social pathologies, which is much higher in Germany than in the USA, but also in a different method of action. The German welfare state tries to eliminate the causes of social pathology (preventive action). At the same time, in the United States social workers mainly take care of people already affected by pathology. Therefore, by nature the German approach is more sociological and the American approach – more psychological. As a result of these different approaches, the number of clients in social care is much smaller in Germany than in the USA, which in the authors’ opinion is a direct proof of the effectiveness of preventive action.

- Knowing the American love of individual freedom, the authors’ thesis that in the USA an individual using social aid is controlled by the state authorities more than in Germany must seem surprising. The authors explain this fact not only in terms of a different concept of the welfare state, but also by reference to the allergy of Germans to all-embracing state control, dating back to the times of fascism. The two American scholars are convinced that it is still justified to term the American system as highly individualistic, and the German one as communitarian. There is also no doubt, that in two other European countries communitarian attitudes prevail, that is in Austria and Sweden. Will the recent accession of these countries strengthen this current within EU? On what does the future of German socio-economic system depend? Suzan Berger seems to believe that it depends not so much on the communitarian attitude of German society, as on the will and commitment of the power elites. She has tried to capture the logic of competition between a system aimed at maximising short-term profit and that whose goals and resources are more socially oriented. “Absent is a political will to sustain institutions and values that transcend efficiency and growth, no national traditions, culture, or historical legacies by themselves can restrain market forces. Seen from this perspective, even if the Japanese and German systems do better in the long run, they are vulnerable. In a competition between the long term calculations about the uses of labour, resources, and capital characteristic of the political economies of these two countries in the post-war period and the short-term profit maximising of Anglo-American capitalism, economic opportunism will win. When deregulation or open borders give national capitalists the chance to escape constraints on wages, working conditions, layoffs, financial speculation, mergers, or environmental protection, they will – no matter their previous involvement in social democratic neo-corporatist, or Japanese-like lifetime employment systems. Given the general decline of the left and indeed of all those political forces in Western advanced societies that might sustain collective action on behalf of values other than competition and efficiency, market forces confront little opposition” (Berger 1996: 12).

The quoted words were written before the SPD came to power. There was a very short period, connected with Oskar Lafontaine, when one could have thought that the social democratic government would try to implement the traditional SPD policy of social accord based on compromise between capital and labour. Its policy was, however, full of zig-zags, which is why G. Schroeder was called by one of British newspapers, as “a swinging Chancellor”. Understandably therefore it is very difficult to guess what the SPD’s second term is going to bring. The outcome will also depend on the pressure of the CDU, whose leaders still seem to regard the social market economy as being a value that is worth defending. Here is what the chairman of the CDU Parliamentary fraction, W. Schäuble, told a Polityka journalist when asked about his opinion about the conflict between Rhine capitalism and Anglo-Saxon capitalism: I prefer the traditional concept of the social
market economy (...). Germany was doing quite well with its model. Now we have some problems, because our model is too bureaucratic. However, we are starting reforms, trying not to move too close to a pure market economy. We will always have a social market economy, based on the elimination of differences by political means (Schauble 1998). However, the most decisive factor, which may compel the authorities to stop dismantling SME, will be the pressure of social movements, which have been growing in the last couple of years both in Germany itself and on an international scale.

4. Poland’s social and economic burdens

Western public opinion has long been informed about the great success of the Polish economy, whilst the ugly side has been, till recently, ignored. It is true that from 1994 to 2000 the Polish economy expanded rather rapidly (on average over 5% per annum rate of GDP growth). But for the whole period of transition (1989-2002) the rate of growth in Poland and in the EU was exactly the same (2.1%). For the whole period of transformation Poland’s economy has experienced the greatest increase of GDP among the post-communist countries. However, the so-called “growthmanship” illusions helped to maintain a myth of successful transformation. For a long time it was ignored that this was a very one-sided type of growth. The Polish variant of the “trickle down” theory served rather as an ideological legitimisation of the emerging system. That is why Poland is facing several very serious social and economic problems. Additionally, the probable ‘after-accession shock’ may aggravate these problems. If we want to be prepared to deal with these problems, then it is necessary to analyse them before accession arrives.

Massive and permanent unemployment

Unemployment grew from almost zero in 1989 to more than 16% in 1994 and after a temporary but not radical decline, it started to rise rapidly in the subsequent three years, approaching 1/5 of workforce. Even before the present recession, in the years 1998-2000, when there was still quite a high rate of economic growth (over 4% per year), the level of employment was declining. Quite a number of the unemployed went back to the village, augmenting disguised unemployment in agriculture. And what is more important is that the proportion of the employed entitled to benefits has been declining rapidly, due to our very restrictive law, with less than 20% of them receiving benefits in the Summer of 2002. In this situation, many of the unemployed see no advantage in being registered (Lagodzinski 1999).

Unemployment presently mainly threatens the youth, as Poland is passing through, and will be facing for a couple of years ahead, an exceptionally rapid growth of young entrants to the labour market. This helps to explain why as many as 45% of young people (below 24 years old) remain unemployed. Thus, this exceptionally high rate of joblessness will surely continue to be a great and painful problem unless deliberate and broadly programmed action is taken. Unfortunately, the present governing coalition has undertaken inadequately modest measures designed to tackle unemployment and they assume that it will be still higher at the end of its term in office in 2005. The problem of unemployment is tightly connected with the difficult material situation of farmers (see below) and the housing catastrophe. Because of this a large section of the unemployed are located in the countryside, lacking both a place to live and work with the social advancement of the youth in the countryside severely hampered. Very recent information shows that only one in every 130 children, from a peasant background, reaches higher education. The conditions for the youth from the countryside to gain a profession are also very bad.

Widespread and growing poverty

The transformation period brought about a significant impoverishment for a large section of the population and a continual growing tendency of growing poverty. According to the Vienna Institute of Human Studies (Rada 1998:24), the number of people receiving half of the average disposable income or less (on an equivalent basis) amounted in 1995 to 18.3% in Poland, 9.3% in Hungary, 6.7% in Slovakia, 6.1% in the Czech Republic and 6.6% in East Germany. The subsequent years of high GDP-growth brought,

<table>
<thead>
<tr>
<th>Year</th>
<th>Social Minimum</th>
<th>% Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>32,4</td>
<td>20.0</td>
</tr>
<tr>
<td>1996</td>
<td>54,0</td>
<td>32,4</td>
</tr>
<tr>
<td>2000</td>
<td>57,0</td>
<td>43,0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Minimum Existence</th>
<th>% Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>13,3</td>
<td>4,3</td>
</tr>
<tr>
<td>2000</td>
<td>13,6</td>
<td>8,0</td>
</tr>
<tr>
<td>2001</td>
<td>15,0</td>
<td>9,5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Legal Poverty Line</th>
<th>% Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>13,3</td>
<td>13,3</td>
</tr>
<tr>
<td>2000</td>
<td>13,6</td>
<td>13,6</td>
</tr>
<tr>
<td>2002</td>
<td>15,0</td>
<td>15,0</td>
</tr>
</tbody>
</table>

Source: (Drył 2002) All data comes from research done by the Main Statistics Office (Głownego Urzdu Statystycznego.) The social minimum is fixed every year (like the minimum existence) by the Minister of work and Social Affairs, allowing for the maintenance of a decent standard of living, e.g. having the necessary minimum expenditure for cultural activities. The minimum existence allows for the ability to satisfy the needs for a biological minimum standard. Those on an income lower than that mentioned above are entitled to receive social benefits.
surprisingly, substantial further impoverishment. Here are a few figures showing the percentage of people in poverty, according to the three definitions of poverty: social minimum, minimum existence and the legal poverty line (Table 1). Although comparisons are more difficult here, the proportion of Polish people living in poverty is one of the highest in Europe west of the Ukraine. There is no doubt that the exceptional dynamics of growing poverty was prompted mainly by the growth of unemployment. At least five other factors should be mentioned:

- A sharp fall in real wages during the first two years of transformation, and its very slow increase afterwards;
- A “planned” lack of sufficient finance to fill the state obligation to persons getting income below the legally defined poverty line;
- Frequent cases of paying wages below the minimum wage. A new phenomenon, has recently emerged, “on job with suspended payment” (called in Polish “na bezplaciu”) practised often for several months by hundreds of private firms;
- A decline in the effective transfer of wealth, which for a few years has increased instead of decreased differences (opinion of Prof. S. Golnowskiej in Dryll 2002);
- A rapid growth in homelessness. It is estimated that the number of homelessness stands between a few tens of thousands to a few hundred thousand people. Excepting the general level of poverty there are a few other shocking factors which contribute to this problem. These include ‘unrealistic’ rents, increased rights for evicting tenants and the lack of small-scale social housing and hostels.

Exceptionally large disparities of wages and incomes

These are associated with mass unemployment and the large sector of the population affected by poverty. As several research studies (Milanovic 1995, Atkinson 1996, Borkowska 1998) show, Polish disparities of income are the highest among central European countries and are amongst the highest of the Western Europeans. Inequality, measured by a Gini coefficient (in 1996 - 34 for household incomes, 30 for wages), outstripped the majority of countries in Europe. “In 1999 Poland entered the group of the most inegalitarian countries such as Italy and the USA.... Higher ‘non-civilised’ disparities are only in Albania and Russia” (Golinowska, 1999). We do not posses the data for the last three years, but one may be sure that they brought further increases of inequality.

The greed, or rather lack of top manager’s restraint in increasing their benefits, merits particular attention. Their earnings are already more than 60 times the average wage, a rate similar to that displayed in the United States a dozen or so years ago. Moreover, managers’ salaries are still rising rapidly; led sometimes by the heads of state owned firms (this could not have happened without the quiet acquiescence of governments even with a left wing label). Poland also comes out very badly in comparative studies of wage discrimination against women. Before our eyes and with our silent or active complicity, we can see how an oligarchy of wealth has emerged (Harrod 1958 quoted by Hirsh 1977:23) bringing with it an oligarchic democracy. However policies designed to assist the poor, which are attracting increasing popular support, are likely to perpetuate the inegalitarian system rather than destroy it. This is the ‘paradox of redistribution’ (Korpi, Palme 1997) which confronts social democratic governments.

Nineteenth Century working conditions in the private sector

In Poland, private firms generally do not respect health and safety regulations at work and do not comply with the conditions laid down in legally obligatory written contracts of employment. In regions of high unemployment and/or immigration from the East and the South, wages are often below the statutory minimum. Trade union activity is more than frequently not allowed, which is why “in the new private firms trade unions are practically absent, and in privatised firms are disappearing” (Gardawski, 1999, 2001). At the outset, this could be explained by the inexperience of the new owners, the exceptional situation, reorganisation and therefore a temporary breakdown in monitoring. We should, however, be deeply disturbed that the annual report of the State Labour Inspectorate (PIP) indicates that working conditions are far from improving, and actually are getting worse. Hopes for the private sector becoming more civilised are dangerously fading out.

The catastrophic situation with regard to housing

The number of apartments we are building now is about one third of the number we built thirteen years ago, despite waiting lists for a municipal flat of 5-8 years. This is despite mass unemployment, and a huge excess of production capacity in the steel mills and cement industry.
Uncertainty of social and employee entitlements

In order to finance transfers to growing numbers of poor people, including the unemployed and pensioners, the authorities felt compelled to cut pensions and other benefit levels. This is understandable perhaps, but ultimately must be attributed to a failure to combat unemployment. However the authorities have many times repeated that the Polish economy is over-socialised and declared their intention of reducing the share of state expenditure to one third of GDP. Poland belongs to those countries, which is reducing its scope of redistribution most rapidly and we are approaching the level of Great Britain. In the Spring 2002 the present coalition, with the logo of the left, introduced a new law constraining employee entitlements (making the labour market more flexible), even although such liberal economist like O. Blanchard expressed the opinion that the recession is the worst time for such reforms.

Annihilation of trade unions

A huge social problem is the disappearance of the trade unions. They are virtually non-existent in the private sector (which makes up over 70% of GDP) with a clear tendency towards their complete disappearance. This primarily effects small and medium firms, although not exclusively. Also in a number of renowned western firms, from countries where trade unions are treated as business partners, there is an informal, although barely concealed, ban on the formation of trade unions. This situation is reminiscent of America during the thirties. Two historians of the trade unions wrote: “To the American labour movement the conquest of the right to exist was ever its paramount problem (…), to the American employers unionism has always remained the invader and the usurper to be expelled at the first opportunity” (Perlman, Taft 1953: 621). In the words of one of the researchers of social exclusion in Poland, one can say that: “Poland has the most unequal income distribution with a huge concentration of low wages and a small concentration of high (on a position higher than in countries richer than Poland) of wages. To put it in other words, set against all other countries of central Europe Poland is pursuing the most elitist model of income distribution” (Beskid, 1998: 42).

5. Conclusions

Let us come back now to the fundamental questions facing Poland with regards its EU accession, alongside its mounting social and economic problems. I hope that in light of what has been said above, the reader will understand that Poland needs an extremely ambitious programme enabling a thoroughgoing recovery comparable to that of the United States or Germany in the thirties. In such a situation, one cannot rely simply on a cyclical recovery. This task clashes with an “accession procedure as usual”, which would most probably aggravate all the enumerated social problems and tensions. In this situation responsible politicians cannot rely only, or even mainly, on market forces.

A number of authors have already shown that the Polish economy is not very competitive. In addition, as is shown from the experiences of southern European countries, immediately after accession there is a radical growth in FDI with an influx of high technology and modern organisational economic activities. An effect of this process is that business re-structuralisation is speeded up meaning that a significant growth in GDP will not create a growth in employment. On the other hand the scale of unemployment, especially that of youth unemployment, strongly connected with poverty, is so huge that normal monetary and fiscal tools are not in a state to face this challenge. Indispensable, therefore, are the deployment of extraordinary measures such as public work schemes; organising young people to build homes for themselves and others and the engagement of public authorities (in a similar fashion to what occurred in Germany directly after the war) in building flats and infrastructure. Can such developments occur within the institutional-organisational framework of the European Union? The answer to this can only be negative. Can we count on changes to the functioning laws to allow such a program to be implemented? Again the answer would seem to be negative. It seems that only unconventional solutions as an absolute exception to the rule, could be applied here, admitting that Poland finds itself in an unusual situation and that this situation demands exceptional solutions. This would obviously demand not only the EU being prepared to recede its ground but also a strong commitment and ability of the Polish authorities to energetically apply these solutions.

Bibliography

Albert Michael, 1994, Kapitalizm kontra kapitalizm, “Znak”, Kraków


Dornbush Rudi, 2001, Świat już jest w recesji, “Rzeczpospolita” 21-22 października

Dyll Irena, 2002, Czy można zwalczyć biedę? “Nowe Zycie Gospodarcze”, 5 June

Eatwell John et al., 1997, Not “Just another accession”, London


Gardawski Juliusz, 1999, Bezpieczne związki, “Gazeta Wyborcza”, 27 August

Gardawski Juliusz, 2001, Związki zawodowe na rozdrożu, Instytut Spraw Publicznych, Warszawa

Golinowska Stanisława, 1999, Niedza, ubóstwo, niedostatek, “Rzeczpospolita”, 9 September


Harrod Roy, 1958, The possibility of economic satiety.


Komolowski Longin, 1999, Komentarz, “Wprost” 5 March


Kulakowski Jan, 2002, Interview, “Rzeczpospolita”, 13-14 July

Lagodzinski Witold, 1999, Strach przed biedą, “Rzeczpospolita”, 27 August


Pischke Joern-Steffen, 2001, Comment on Boldrin & Calvo, as above, “Economic Policy”, no 32

Rada, 1998, Podział dochodu i nierówności dochodowe. Fakty, tendencje, porównania, Raport 29, Rada Strategii Społeczno-Gospodarczej, Warszawa

Roth T., 2000, Nowe oblicze gospodarki niemieckiej, “American Studies Journal”, no. 44


Pischke Joern-Steffen, 2001, Comment on Boldrin & Calvo, as above, “Economic Policy”, no 32

Rada, 1998, Podział dochodu i nierówności dochodowe. Fakty, tendencje, porównania, Raport 29, Rada Strategii Społeczno-Gospodarczej, Warszawa


Schauble Wolfgang, 1998, Nie porównujmy jabłek i gruszek, “Polityka”, 6 June

Verheugen Guenter, 2002, Short interview, “Rzeczpospolita”, 21 June

1 Because of a similar policy, Franco Modigliani called former minister of finance Theo Weigel an economic ignorant (Grzybowska 1997).

2 It is interesting that the CDU presidential candidate, Stoiber, promised to abolish this law if he won the election.

3 Translated from Polish edition (1994).

4 It should be added that it is not only the German welfare state model, which has been maintained, with slight modifications. Also the particularly developed Swedish welfare state model is surviving and seems no less effective that the systems of most OECD countries. Sweden still has the highest proportion of state expenditure of GDP in the world (approx. 65% in 1996).

5 According to Vienna Institute of Human Studies comparative research, an average of the total (main job and additional) earnings of women was 56.7% of man’s earnings, lower not only than in Bulgaria, Czech Rep., Slovakia, Hungary, but also in Russia (Domanski, 1997:124).

6 I regard the emerged system as one of the most unjust social orders experienced in Europe during the second half of the twentieth century. The above-presented problems are simultaneously the most important characteristics of the present social and economic system, which has emerged during the last thirteen years. They were not necessary, but are the result of a political choice, a choice of a certain way of development and socio-economic model as a goal. Certainly, the system will continue to change. The public sector will contract in favour of the private sector, and there will be further marketisation of the state sector including in social services. But it is almost certain that the foundations of the new system, as one of the variants and components of the mega-system called capitalism, have already been laid. If one assumes that strong social movements will not come into the reckoning, then this new system is not threatened by reverses or radical change.

7 A theoretical justification for inaction by the Minister of Labour (formerly a top official of the Solidarity trade union) was the public assertion that the natural rate of unemployment in contemporary Poland is about 8-10% (Komolowski 1999)!
Economic and social development in Slovakia after 1989 and accession to the EU

Ivan Okáli, Milan Šikula

1. Development trends and transformation cycles

Economic and social development in Slovakia after 1989 is still an incomplete history of transformation of economic and social structures from central planning to a state corresponding to market economy.

Slovakia entered into the transformation process as a part of Czechoslovakia. At the beginning of the transformation, advantages of the whole Czechoslovak economy consisted above all in a fairly high level of its industrial development, relative financial stability (small excess of demand over supply, low inflation rate, balanced public finance) and in a low foreign indebtedness. A disadvantage of the Czechoslovak economy at that time was an especially high degree of central control (among all countries of real socialism presumably the highest degree), which was strengthened by monopoly organizational structures and absolute suppression of private initiative. Its obsolete and rigid sector and product structures connected with prevailing orientation at soft markets of the CMEA (Council for Mutual Economic Assistance) also were significant shortcomings.

In the pre-transformation phase Slovakia participated with an industrial structure which was even less effective than the nationwide (i.e. Czechoslovakian) standard. Production of semi-products for enterprises in the Czech republic and production of components of complete industrial plants and heavy armaments for markets of the CMEA and its allies predominated in the Slovak industrial structure.

In the first years of the transformation (1991-1992 and partly also in 1993), the development in the Czech and the Slovak part of the Czechoslovak economy (see table 1).

This markedly worse economic development in the Slovak Republic (SR) than in the Czech Republic (CR) in the years 1991-1992 at macro and micro-levels was the result of the fact that equally strong pressures from economic policy measures and competitive forces hit both regions but worked out differently in the structurally weaker part of the Czechoslovak economy. On this basis, the requirement of independent economic policy able to realize the transformation more effectively, with minimization or also with prevention of losses caused by the common Czechoslovak transformation doctrine to the Slovak economy, has been strengthened since the end of 1991. This requirement played indeed no decisive, but also no negligible role (mainly as regards privatization expectations of a part of the Slovak political elite) in decision-making on the Czechoslovak split.

In the course of 1993, the transformation of the Slovak economy entered into a new stage. Figure 1

From Figure 1 it is possible to deduce that the overall balance and economic performance (measured at the macro-level by GDP growth and at the enterprise level by average profitability) synchronously developed in 4 and 5-year cycles during the whole monitored period. In the first part of every cycle economic policy improved the state of balance, in the second part its state aggravated. In the transformation of the Slovak economy so far we can distinguish three cycles:

The first cycle contains the years 1990-1993. Its transformation contents and different effects on the Slovak and Czech economies were already mentioned. The satisfactory initial level of the overall balance in it rapidly eroded as a result of the one-time application, incompleteness or unbalanced transformation measures. Deterioration of the overall balance was worsened by consequences of the CSFR split in 1993. The unfavorable development of the overall balance was accompanied by a decline in performance (transformation recession).

The inconsistent exercise of state property rights towards non-privatized enterprises, but also the creation of weak property positions in the voucher privatization along with the application of soft budgetary restrictions and lagging behind in institutional reforms led on the one hand to steep increase in indebtedness and insolvency of enterprises and on the other hand created suitable conditions for spontaneous privatization connected with their "tunneling".

The second transformation cycle was a period where an own Slovak transformation strategy was attempted. This was realized in 1993-1998 which created (with the exception of 6 months in 1994) a political cycle connected with the government of V. Meciar.

The data presented in table 1 show that the concept of transformation implemented in Slovakia required considerable corrections after the split of the CSFR. However, the results indicate the impropriety of their contents and methods.

The devaluation of the Slovak crown (in the second half of 1993) and fiscal measures (in the first half of year 1994) ensured an auspicious entry into the second cycle. These measures adjusted exchange rates, prices, wages and other economic variables to the productivity level in the Slovak economy. As a result of these measures, the overall balance significantly strengthened in the Slovak economy. Consequently, with the help of an upswing in the world economy, the transformation recession in the Slovak economy was overcome in 1994 and 1995 with relatively high rates of economic growth (based to a large extent on better utilization of existing capacities).

The revised transformation doctrine, which has been realized in the SR since 1993, embodied two main changes: First, replacement of the voucher privatization by direct sales of assets to selected owners and second, massive state support of economic growth.

The new privatization method had to ensure "the establishment of domestic capital creating class" closely connected with the governing elite. Thus also in the economy isolationist tendencies arose, obstructing the restructuring of enterprises on the basis of their privatization by international firms. However, the Slovak method of privatization created problems by transferring property rights to persons which were not able to use them competently. As a result of the close relation of economic with political elites, enterprises continued to operate in a soft budget regime (exploitation of numerous exceptions in tax paying, toleration to non-payment of contribution to insurance funds, providing unsecured credits by state banks).

Restructuring of selected enterprises had to be achieved by public subsidies and by stimulation of demand by high rates of economic growth. However, the revitalization attempt wrecked shortly after adoption of the respective law. Stimulation of investment demand by increase in the governmental expenditure and governmental guaranties for foreign credits of state firms constructing technical infrastructure also have not brought expected results.

Economic policy (at the macro and micro-levels) of the second part of the second transformation cycle (1996-1998) led to quick deterioration of the overall balance (mainly as a result of deterioration of balance in foreign trade and in public finance which led to an increase in interest rates on credits). However, sticking to the overvalued fixed exchange rate of the Slovak crown prevented an improvement of the overall balance and a return to economic growth. Consequently, initial conditions for entry into the next development stage were even more bleak.

The third transformation cycle started with a replacement of the regime of fixed exchange rates by a floating rate regime and a subsequent depreciation. In 1999, restrictive fiscal policy was adopted. This led to a significant decrease in interest rates on credits (from 19.4% in 1998 to 16.9% in 1999; 11.8% in 2000 and 9.3% in 2001).
In the years 1999-2002, restructuring processes significantly progressed mainly in the bank sector. This sector was relieved, with state aid, of a substantial part of dubious credits (classified) and taken over by foreign banks. Electricity and gas companies were also privatized.

The process of enterprise restructuring led to an increase in the number of bankruptcies and with application of more market principles of their functioning accelerated under a stronger financial pressure and pressure created by institutional reforms. The enterprise restructuring led to a considerable increase in unemployment. Furthermore, in 1999-2000, the increase in unemployment rate was accompanied by a decrease in real wages.

In the first half of the third cycle, the above processes showed up as significant improvements in the overall balance. The economic and political impulses of this change led to a sudden decrease in GDP growth. However, in a short time, (with improving state of balance) the rate of the economic growth gradually accelerated (year-on-year GDP growth in successive quarters was as follows: in year 1999 0.7%; 2.4%; -0.4%; 2.6%; in year 2000 1.2%; 1.8%; 2.5%; 3.2%; in year 2001 3.0%; 2.8%; 3.5%; 3.9% and in year 2002 3.9%; 4.0%; 4.3%), and the situation of enterprises improved significantly.

The illustration of main trends in economic development in Figure 1 shows that also in the second half of the third cycle (in years 2001-2002) the overall balance of the economy repeatedly deteriorated as in the previous transformation cycles.

A number of questions may be raised. Above all, why have the transformation cycles realized in the economy of the SR not ended yet? Why did the economic and political measures applied in 1999 in favor of the overall balance improvement not have a lasting effect? What must be done, what conditions must be met so that the transformation cycles may be dampened and economic growth can be pushed up?

Deterioration of the overall balance in 2001 was undoubtedly caused to a large extent by the recession in the world economy. In 2002, its negative trend was strengthened by the economic and political measures related to completion of the political cycle (significant liberation of fiscal policy, temporary postponement of price deregulation, leading to a slower price increase and consequently to significant real wages increases; at the same time, the increase in governmental expenditures and wages led to a deterioration of the trade balance).

In the interest of achieving a more durable state of balance in the economy of the SR and in view of the temporary character of the above nonstandard effects, it is inevitable:

- To implement stabilization measures by which deterioration of the overall balance at the beginning of every cycle will be overcome;
- on the basis of completion of enterprise restructuring, reform of the social security system, healthcare and education, completion of price deregulation, to eliminate focuses of origin or renewing of imbalance in economy;
- to maintain in the long run a pace of the economic growth at level 4-5% of annual GDP increase and to improve the quality of the economic growth so that the increase in value added is achieved with less energy, raw material and lower import intensity, or so that the increase in economy performance is accompanied with reducing trade balance tensions; a policy fostering competitiveness (industrial policy) is necessary to focus on achieving of the above goals.

In the interest of achieving a more durable state of balance in the economy of the SR and in view of the temporary character of the above nonstandard effects, it is inevitable:

- To implement stabilization measures by which deterioration of the overall balance at the beginning of every cycle will be overcome;
- on the basis of completion of enterprise restructuring, reform of the social security system, healthcare and education, completion of price deregulation, to eliminate focuses of origin or renewing of imbalance in economy;
- to maintain in the long run a pace of the economic growth at level 4-5% of annual GDP increase and to improve the quality of the economic growth so that the increase in value added is achieved with less energy, raw material and lower import intensity, or so that the increase in economy performance is accompanied with reducing trade balance tensions; a policy fostering competitiveness (industrial policy) is necessary to focus on achieving of the above goals.

In the interest of achieving a more durable state of balance in the economy of the SR and in view of the temporary character of the above nonstandard effects, it is inevitable:

- To implement stabilization measures by which deterioration of the overall balance at the beginning of every cycle will be overcome;
- on the basis of completion of enterprise restructuring, reform of the social security system, healthcare and education, completion of price deregulation, to eliminate focuses of origin or renewing of imbalance in economy;
- to maintain in the long run a pace of the economic growth at level 4-5% of annual GDP increase and to improve the quality of the economic growth so that the increase in value added is achieved with less energy, raw material and lower import intensity, or so that the increase in economy performance is accompanied with reducing trade balance tensions; a policy fostering competitiveness (industrial policy) is necessary to focus on achieving of the above goals.

In the interest of achieving a more durable state of balance in the economy of the SR and in view of the temporary character of the above nonstandard effects, it is inevitable:

- To implement stabilization measures by which deterioration of the overall balance at the beginning of every cycle will be overcome;
- on the basis of completion of enterprise restructuring, reform of the social security system, healthcare and education, completion of price deregulation, to eliminate focuses of origin or renewing of imbalance in economy;
- to maintain in the long run a pace of the economic growth at level 4-5% of annual GDP increase and to improve the quality of the economic growth so that the increase in value added is achieved with less energy, raw material and lower import intensity, or so that the increase in economy performance is accompanied with reducing trade balance tensions; a policy fostering competitiveness (industrial policy) is necessary to focus on achieving of the above goals.

The results of economic and social development in Slovakia in the years of its independent state exis-
The data in table 2 indicate that so far the negative effects of the transformation process concern to a larger extent the social sphere than economic performance. Economic performance achieved the pre-transformation level already in recent years, while in the field of unemployment and real wages the economy is still very far from the state in 1989. It is also necessary to mention that in every transformation cycle, the overall balance was renewed to the detriment of the social situation of population. Because there is the need of maintaining not only economic, but also social balances, this creates certain limits for the reform economic policies in the forthcoming years.

2. Economic and Social Contexts of Slovakia’s Accession to the EU

The accession to the European Union represents a unique historical chance and an existential necessity, which, from the standpoint of national and state interests, has no reasonable alternative. The Institute of Slovak and World Economy of the Slovak Academy of Sciences elaborated an initial study on the economic and social contexts of Slovakia’s accession to the EU as an organic part of the successful endeavour to catch up with the first group of candidate countries.

The basic goal of the study was to elaborate relatively comprehensive scientific arguments on economic and social contexts explaining the existential necessity of Slovakia’s political and strategic direction to the EU. At the same time, it attempts to provide a balanced view of both the benefits and risks.

The results of the study should significantly help to overcome the low and insufficient availability of information and the consequential unrealistically optimistic and overly pessimistic expectations. Also related to this is the somewhat wide-spread presumption that a large number of problems and difficulties in our economy and, in particular, the demanding nature of their resolution are or will be connected with and brought about by the integration into the EU. In this context, the study is designed to show that amid sharpened global competition we will have to cope with most of the problems anyway and that the integration process is something that can facilitate and speed up the necessary adaptation to globalisation. If we prepare for accession to the EU effectively and make use of the chances and possibilities related to it efficiently, the integration into the single economic area will act as a catalyst of the effective adaptation of our economy.

Macroeconomic and institutional framework of accession to the EU

Developments in transition economies and their comparison with economic development in EU countries prove that steadiness of growth is an indispensable condition for convergence. This in turn (as experience shows) is largely conditional upon maintaining the economy in a state of balance, which requires both responsible economic policy, and, in Slovakia and in other transition countries, particularly the full completion of reforms.

The causality works in both directions in the relationship between stability and growth. The reason why emphasis was placed on just one of its sides, in particular on the direction of impulses flowing from balance to growth, is that Slovakia, endeavoring to accede to the EU, has a transition economy with factors creating strong imbalances and a poorly effective stabilization mechanism.

It is not the integration itself, but rather the current internal characteristics of the functioning of the Slovak economy that are the main risk factors threatening its stability. The chronic inclination toward imbalances caused by the insufficient factors threatening its stability. The chronic inclination toward imbalances caused by the insufficient level of competitiveness has been, on a number of occasions, eliminated only temporarily through various packages of stabilisation measures.

The high intermediate consumption and import intensity embedded in production makes the economy vulnerable. This is further amplified by the inclination of public finance to reproduce deficits and debts.

The final stage of preparations for accession to the EU must therefore be a phase of prudent fiscal policy combined with an effort to reform the problematic areas of the public sector. Along with the elimination of other deformations of the market environment, this should lead to the creation of conditions enabling the Slovak economy to behave as a standard market economy and thus eliminate the specific transformation factors affecting the business cycle fluctuations.

Initial level of the Slovak economy’s competitiveness

The key priority for candidate countries in the preparation for accession to the EU is the convergence of the economy in terms of competitiveness.
The Slovak Republic is also facing the task of meeting the above criterion, because the level of the Slovak economy's competitiveness is as yet relatively low in general. Using as an indicator GDP per head, measured by per capita purchasing power parities (PPPs), Slovakia reaches only 49% of the EU average.

Another manifestation of low competitiveness is the trade balance deficit. In the 1994-1999 period, Slovakia had a deficit -7.2% (% of GDP). Compared with other candidate countries the Slovak economy has the lowest share of domestic production in domestic demand (consumption and investments).

The most serious fact, however, is that the main risks to the Slovak economy's competitiveness on the doorstep to the EU are caused by considerably lagging behind in productivity. It only reaches roughly a half of the EU average (GDP per employee using the US$ / PPPs) and only about 20% when calculated using the current exchange rate. The low productivity is the decisive cause of low comparable price level which at the end of 2000 reached only 36% of the EU average. The low qualitative competitiveness is still reflected in unfavourable terms of trade.

The key problem of increasing the Slovak economy's competitiveness lies in the reduction of the lagging behind in labour productivity, combined with an increase in the share of value added in gross production.

In connection with low labour productivity and low value added rate in the Slovak industry compared with the EU average, Slovakia also records low per employee wages.

In 1997, Slovak nominal monthly wages per employee in the production of tradable goods reached only 10.3% of the level in advanced EU countries. Obviously, real wages per employee (measured by PPPs) were higher. Yet they were still only 28% of the level in selected EU countries.

Since 1989 the sectoral structure of the Slovak economy has become more similar to the proportions typical for EU member states. However, if we divide the structure of production and services into more detailed layers, the lower share of modern technology and knowledge intensive activities is apparent.

Slovakia's economic development is further accompanied by the creation and deepening of disparities between regions (administrative regions, but especially districts). The per capita GDP generated in the economically most developed Bratislava region in 2000 was twice the Slovak average and more than three times the per capita GDP in the least developed Prešov region. The unemployment rate in 2001 reached 24.8% in the Košice region, but only 8.3% in the Bratislava region. There is therefore a chance to acquire means from structural funds and the Cohesion Fund during the first years following accession to the EU. The receipts are estimated to reach 1.8 billion € in 2004-2006.

On the basis of orientation calculations it is possible to expect the following effects of Slovak's accession to the EU on her economy:

**Integration effects**

More intensive inflow of foreign direct investment (FDI) to the Slovak economy is how the integration into the EU can help to ensure productivity growth, which is the key factor of a substantial increase in competitiveness. It can be expected that the EU single market will provide more opportunities for Slovakia in the field of foreign direct investment inflow by advancing the processes of intrasectoral micro-specialisation aimed at greater utilisation of economies of scale, as well as by deepening the process of product differentiation in the EU and imitation in Slovakia.

According to model calculations, taking into account the above estimate of the developments in the FDI volume, productivity in Slovakia could grow at the average annual pace of 3.7% in 2004-2008.

**Budgetary effects**

The aggregate effect of the future tax harmonisation (rise in revenues from indirect taxes and decline in revenues from direct taxes) should be beneficial for the Slovak state budget as well as for the co-financing of structural projects.

The total amount of pre-accession assistance for Slovakia in 2001-2004 could reach Euro 414-614 million, which is SKK 18-27 billion.

The study estimates that in the 2004-2008 period Slovakia could realistically absorb funding from EU structural funds amounting to approx. SKK 12-18 billion annually (Euro 0.3-0.4 billion), i.e. approx. 1.1% of GDP.

**Costs associated with the implementation of EU standards and regulations**

Slovakia's accession to the EU will be associated with relatively high, mostly investment costs.

For example, the total cost of achieving compliance
with EU standards and regulations in the field of the environment by 2007, or 2015, can be estimated at SKK 120-140 billion (in 2001 prices). The total expenditure of enterprises incurred by the implementation of all safety and health standards is estimated at SKK 20-30 billion.

Basic characteristics of macroeconomic scenarios

Econometric scenarios have been elaborated to give a preliminary quantitative outlook as to economic and social trends, assuming Slovakia's accession in 2004.

The revenue and expenditure effects related to the adoption of the principles of budgetary policy and implementation of the acquis will add around 1% to GDP growth. Real economic growth of the Slovak economy in 2004 - 2006 could reach 4.8% annually and as much as 5% in 2007 - 2008. Analogous real growth in overall labor productivity should oscillate around 3.5% - 3.9%.

If the anticipated increase in competitiveness does materialize, exports should rise at the average pace of 12.2% in 2004 - 2008. At the same time, imports should rise slightly slower than exports and the current account deficit could therefore be reduced to acceptable - 3.2% of GDP in 2008. Inflation rate should span from 7.1% in 2001 to anticipated 3.8 - 5%. Average nominal wage should increase by 8.7% in 2002 - 2003 and by 9.7% annually in 2004 - 2008.

An increase in employment of approximately 1% achieved in 2001 is expected also in 2002 and 2003. Employment should rise by 1.2% annually between 2004 - 2008, consequently the unemployment rate could fall from current 19% to the level of around 15% in 2008.

Model calculations of economic convergence show that GDP per capita using PPPs reached 48.5% of the EU-15 average in 2001. It should increase to 52.1% in 2004 - 2006 and 54.9% in 2007 - 2008. Analogous model calculations of comparative price level show that the price level in Slovakia reached 36.9% of the EU average in 2001. It should rise to 44.6% in 2004 - 2006 and 49.7% in 2008.

From the nature of model simulation calculations it is obvious that these results have only orientation character.

3. Policy Recommendations

The economy enters the EU with its given structure. Therefore all structural components and hierarchic levels should prepare efficiently and adapt rapidly so they will be able to effectively communicate with relevant integration partners. The nearer the date of the entry, the more historical proclamations lose importance and hard and more concrete calculations of costs and benefits, advantages and disadvantages get attention. A requirement to exactly formulate a national and state interest which would realistically reflect weaknesses and strengths, possibilities and opportunities as well as risks and threats so that it will be mobilizing for Slovakia as a candidate country and convincingly arguing for integration partners increases. On this basis Slovakia should elaborate its short and medium-term integration strategy with particular regard to completion of transformation reforms.

However, the real transformation will conclude only after our accession to the EU, under uncompromising influence of advanced integration environment, it is inevitable to make use of the remaining time till May 2004 for minimization of severe deformations in form of high corruption, insufficient law enforceability and serious shortcomings in utilization of pre-accession aid from the EU as well. At the same time, it is necessary to accelerate preparations of nonbureaucratic operational administrative capacities which will be able in relatively short start-up time to absorb integration aid from structural and cohesion funds.

As regards the policy of current member states, it would be desirable that they do not see integration aids to new members only as a sacrifice of Europe reunification, but consider them also and mainly as good investments in the creation of larger, more homogenous and economically advantageous economic region in which the developing potential of all participants and thus also competitiveness of whole European union will increase.

Model calculations of economic convergence show that GDP per capita using PPPs reached 48.5% of the EU-15 average in 2001. It should increase to 52.1% in 2004 - 2006 and 54.9% in 2007 - 2008. Analogous model calculations of comparative price level show that the price level in Slovakia reached 36.9% of the EU average in 2001. It should rise to 44.6% in 2004 - 2006 and 49.7% in 2008.

1 Development of state of the overall balance is found out on the basis of summarization of following partial indicators: inflation rate in retail prices, ratio of trade balance to GDP in %, ratio of state budget balance to GDP in %, average interest rate on commercial credits in %, difference between annual change in productivity from GDP in constant prices and annual change in real wages in points. The Individual indicators were every year assessed at intervals of 100 to -100 points according to ratio of their annual value to average of the whole monitored period. The average of point summation in respective years to single indicators is recorded in the chart.
Slovenia: Alternative Economic Policies in Action

Joze Mencinger

1. Economic and Social Development Since 1989

Slovenia, as a part of Yugoslavia, shared its advantages and disadvantages compared to other socialist countries in Eastern Europe, particularly a rather specific economic and political system. Many of the essentials for successful economic transition were, at least partly, met before 1989; enterprises were autonomous, basic market institutions existed, and government used some standard economic policy tools. In addition, Slovenia was far the richest part of Eastern Europe: homogeneous, socially stable population; a diversified manufacturing sector; predominantly private agriculture, partly private service sector, well established economic links with western markets; and geographic position were among the advantages.

Independence brought predictable economic results induced by dramatic reduction of trade with former Yugoslav republics. Production was pushed down to 9.3 percent in 1991, and additional 6.0 percent in 1992. Employment went hand in hand with the decrease of economic activity; total employment fell by 5.6 percent in 1992, and by 3.5 percent in 1993. The so called restructuring of the economy consisted mainly of “firing and retiring”; the number of unemployed nearly quadrupled in three years, total unemployment reached 137 thousands in the last quarter of 1993, with official unemployment rate exceeding 15%, the number of pensioners doubled in the same period to 408 thousands. Both demanded enormous social transfers and increase in the share of public expenditures in GDP. At the same time, a switch from the former Yugoslav to the “genuine” foreign market led to a trade surplus in 1992 which was a joint result of increased exports and reduced imports due to the contraction of domestic demand and vanishing links with the rest of Yugoslavia.

In 1993, the country reached the bottom of the depression. GDP increased slightly, and turned to growth. While rapid recovery ended in 1995, macroeconomic performances in the first decade of the country existence can be considered satisfactory. Growth stabilized on the 3-4 percent annually, unemployment acquired European characteristics based on asymmetric employment patterns (Mencinger, 2000), prices have been gradually stabilized, and the budget remained roughly balanced. Surplus in services has until 1999 outweighed deficit in trade, and foreign exchange reserves have, except in 1999 and 2000, matched foreign debt.

The double transition, from a socialist to a market economy and from a regional to a national economy, was accompanied by structural changes from manufacturing towards services, and from large towards small enterprises. Restructuring has been gradual, disorganised, and managed by enterprises themselves, and only occasionally combined with ad hoc government interventions in cases of large troubled companies.

The controversy of “shock versus gradualism” arose in Slovenia during preparations for independence and immediately afterwards. The “shock therapists”, supported by foreign advisers suggested an overwhelming package encompassing price stabilization, fixed exchange rate, balanced budget, administrative restructuring of the manufacturing and of the banking system, and centralized privatisation. Gradualists, on the other hand, suggested decentralized privatization, gradual construction of missing market institutions, and flexible monetary policy based on floating of the new currency. Gradualism prevailed which relates both to economic policy and to changes in the economic system. Despite fallacies and problems, privatisation in Slovenia could be considered a kind of “second best solution” and caused less damage than in other CEE countries.

Pragmatism proved successful in preparing institutional settings for a “new” country and characterized macroeconomic stabilization as well. Independence of the central bank (Bank of Slovenia, BS), prompt introduction of floating exchange rate, and benign neglect of inflation were the cornerstones of macroeconomic stabilization. Such a policy mix was at odds with the then prevailing doctrine. During initial consolidation the BS managed to determine the appropriate amount of money for a new country, and to lessen inflationary expectations. Fears of continuing shortages of foreign exchange have not realized; indeed, BS had to intervene to prevent excessive real appreciation; the largest interventions (purchase and sterilization) took place in the second half of 1994 and in 1997. Decline of inflation which was due to reduced inflationary expectations augmented by increased competition home and abroad and very
favourable terms of trade allowed gradual reduction of nominal and real interest rates.

Social stability has remained an important characteristics of Slovenia; it has been based on regional dispersion of industry, which together with land holding limits of 10 hectares created part time farmers as an important social group. Social costs of transition were paid by middle age inadaptable industrial workers. The majority of Slovenian population quickly adapted to a new political order and accepted it as legitimate which implies that the support for democracy has become largely unconditional and independent of its economic and social effects (Bernik, Malnar, Toš, 1997).

The ambiguous role of the former political elite in the transition process often raises a question whether this elite would like to reproduce the old socialist political system. This is nonsense. A vast majority of former members of the League of Communists had already in the 70s changed into a sort of bureaucratic elite which could easily adapt to any changes and to any system of values. Furthermore, at the end of the eighties, basic consensus on democratisation was achieved without formal negotiations. This partly explains why transition was smooth and peaceful, why the members of the former elite became an ally of the emerging civil society against Yugoslav authorities, why they adapted so quickly and successfully to changes in the society, and why they became the winners in the process of transition. This, no doubt, is an issue which threatens the moral foundation of the society. However, an economist could argue that adaptation of the old elite has been cheaper than creation of a new one.

2. Economic and Social Implications of the Enlargement

Going straightaway “back to Europe” has been the goal of all former socialist countries of CEE; Slovenia included. Their enthusiasm for entering EU has been economically founded and so has been the reluctance of existing EU countries for enlargement. Enthusiasm and reluctance are the results of enormous asymmetries of costs and benefits which enlargement would bring to incumbents and to potential newcomers. For the latter, EU has been practically the only market they have had and they could not afford to lose it; they also expected capital inflow, well paid jobs, and fiscal transfers. For incumbents, potential benefits of enlargement are scanty. The trade with CEECs has become practically free by association agreements, and enlargement would not turn small markets into large markets, and EU countries could already with association arrangements reap the benefits of transition. Enlargement would, indeed, lessen their ability to combine benefits of lower labour costs in CEECs with the aim of preserving domestic employment. Thus, one could from the very beginning expect that implementation of “political necessity and historic opportunity” would be postponed. The incumbents who have been finally facing the the by far biggest and most complicated operation and they have apparently remained uncertain about its consequences for the existing distribution of economic power and even more so of political costs and benefits.

What could the EU do to preserve a facade created by promises? It could shift the blame to applicants and curb the process by inventing new and new hurdles until it could afford subsidies and make appropriate changes in the existing decision making arrangements. It could narrow the selection of novices and keep other applicants hoping. Or, it could accept newcomers and treat them as unequal. Recent developments and the so called negotiations on agricultural and financial matters indicate that EU opted for this solution.

What can applicants do? Not much. They have subordinated their development to the aim of joining EU; and facing the dilemma “take it or leave it” they shall “take it”. Enthusiasm which prevailed in CEECs a decade ago has but subsided and has been gradually replaced by realism and even scepticism. It has become evident that petty haggling over costs and benefits will replace enthusiasm, and that catching up with the EU incumbents will be a long term project during which formal financial aid in form of subsidies and different types of technical assistance from the “West” will be more than offset by visible and invisible flows of wealth in the opposite direction. It has also become evident that the institu-

<table>
<thead>
<tr>
<th>Country</th>
<th>Inflation %</th>
<th>Interest rate %</th>
<th>Budget deficit/GDP</th>
<th>Public debt/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain(1994)</td>
<td>4.7</td>
<td></td>
<td>6.1</td>
<td>62.6</td>
</tr>
<tr>
<td>Portugal (1994)</td>
<td>5.2</td>
<td></td>
<td>5.9</td>
<td>63.8</td>
</tr>
<tr>
<td>Greece (1996)</td>
<td>8.2</td>
<td></td>
<td>7.5</td>
<td>111.6</td>
</tr>
<tr>
<td>Czech R. (2001)</td>
<td>4.7</td>
<td>7.0</td>
<td>5.7</td>
<td>35.0</td>
</tr>
<tr>
<td>Estonia (2001)</td>
<td>5.8</td>
<td>10.1</td>
<td>0.4</td>
<td>5.7</td>
</tr>
<tr>
<td>Latvia (2001)</td>
<td>2.4</td>
<td>9.9</td>
<td>1.7</td>
<td>13.8</td>
</tr>
<tr>
<td>Lithuania (2001)</td>
<td>1.3</td>
<td>8.1</td>
<td>1.8</td>
<td>29.1</td>
</tr>
<tr>
<td>Hungary (2001)</td>
<td>8.8</td>
<td>12.0</td>
<td>3.3</td>
<td>52.3</td>
</tr>
<tr>
<td>Poland (2001)</td>
<td>5.5</td>
<td>14.0</td>
<td>6.0</td>
<td>43.2</td>
</tr>
<tr>
<td>Slovakia (2001)</td>
<td>7.3</td>
<td>9.8</td>
<td>3.9</td>
<td>34.2</td>
</tr>
<tr>
<td>Slovenia (2001)</td>
<td>8.4</td>
<td>13.7</td>
<td>1.2</td>
<td>23.3</td>
</tr>
</tbody>
</table>

Source: EBRD, Transition Report Update, May 2002
ional and administrative ability of the newcomers not only to formally accept “acquis communautaires” but also to implement them might be the real hurdle. Though, formally, CEECs have been more than willing to copy laws and regulations and dozens of so called “European” laws have been passed per week by their parliaments, the gap in social behaviour created by forty years of socialism cannot be simply overcome as indicated most clearly by the unification of Germany.

Contrary to incumbents, newcomers will have to join EMU through the ERM2 arrangement which means that they will have to fulfil Maastricht nominal convergence criteria. The existing data indicate that nominal convergence criteria would not cause too many problems. Indeed, in terms of fiscal criteria the candidates are in a better shape than most incumbents were before joining EMU, though, in 2001, budget deficit in four countries exceeded 3 percent. Slovenia has no problems with fiscal criteria but with inflation.

| Tab. 2: Real Convergence? (GDP/capita in PPP US$) |
|-----------------|----------|----------|----------|------------------|
|                 | 1996     | 2000     | 2004     | Years to reach 75 percent of EU15 |
| Czech R.        | 65       | 60       | 68       | 15               |
| Estonia         | 33       | 38       | 48       | 19               |
| Hungary         | 47       | 52       | 64       | 11               |
| Latvia          | 26       | 29       | 36       | 27               |
| Lithuania       | 29       | 29       | 35       | 31               |
| Poland          | 36       | 39       | 45       | 33               |
| Romania         | 33       | 27       | 33       | 34               |
| Slovakia        | 46       | 48       | 56       | 20               |
| Slovenia        | 66       | 72       | 85       | 1                |

Source: Economic Survey of Europe, ECE UN 2002 No.1, Table 5.2.1

What about real convergence? Eight candidates are considered functioning market economies although not yet fully prepared to cope with market competition in the EU. However, and despite relatively high rates of growth in the second half of 1990s the average per capita GDP (in terms of PPP) in the CEECs in 2000 was 39 percent of EU 15; significantly less than Greece, Portugal, and Spain were at the time of their entry. Initial positive effects of institutional changes on economic performance have been waning and catching up with EU might soon come to an end. The gap between Czech Republic and EU-15 in 2000 was wider than it was in 1996, while the gap between Lithuania and EU-15 did not decrease. Indeed, during a likely recession, the existing gap between EU and CEECs might increase rather than diminish. Furthermore, their growth is more and more depending on foreign savings and has therefore been hardly sustainable; current account deficits as a percentage of GDP have been exceeding corresponding yearly increases of GDP since 1995 (Mencinger, 1999). In real convergence, Slovenia has been well ahead of other candidates.

Hopes for safety and stability in economic, social and political sense are the main arguments in favour of accession, while fear of centralization, over-regulation and adverse impacts on some sectors of the economy, particularly on agriculture are the main arguments against accession. It has been generally accepted that Slovenia has no alternative to a membership in EU whatever the costs; seventy percent of trade is with EU and trade is important for a country of only two million inhabitants. For many companies domestic market represents a day or two of their yearly output. The economic impacts of full membership will be rather limited ranging from very positive in the tradable sector to very negative in some other sectors. Social impacts will be scanty; daily life of common people will not change. Support for joining the EU is in Slovenia most likely lower than in other countries, partly because of relatively high standard of living (GDP/capita is higher than in Portugal and Greece) and, partly because of relatively successful development in the decade after secession from Yugoslavia. Both create a kind of self confidence and a sense of self sufficiency.

National identity is not considered to be threatened; Slovenians lived for six hundred years in the Habsburg empire and retained language and culture. English, the »lingua franca« in EU has been already the second language in Slovenia; many young people are fluent in it, most understand it. Indeed, entering EU might be much less dangerous for Slovenian culture and language than for cultures and languages of some bigger nations. Sovereignty is another issue. Slovenians would opt for EU being an alliance of nation states rather than a federation. There are at least two reasons for that; experiences with the Yugoslav federation and the fact that independence was gained only a decade ago.

3. Policy Recommendation for Slovenia

Economic policies in the candidate countries, Slovenia included, have been more and more concentra-
ting on nominal and real convergence criteria, and particularly on the state at which the countries would enter ERM2. The success or failure under ERM2 regime will namely to a great extent depend on the “equilibrium” exchange rate, inflation, budget and current account balance at the moment of entry. There have been some trade-offs between nominal and real convergence. Thus, for example, too much importance given to nominal convergence criteria, such as fiscal deficit might adversely affect growth while abolition of relative price discrepancies between a candidate and EU might increase inflation. The exchange rate determination will be the pillar of economic policy transmission; it shall be affected by capital flows and exchange rate regimes.

Slovenia has been known as rather cautious towards FDI and particularly towards portfolio investments. While it is true that Bank of Slovenia has since independence tried to prevent real appreciation by lessening the flows of portfolio investments, there was no policy to prevent FDI. They have been relatively low simply because the country could manage without them; domestic companies had experiences with foreign markets even before transition, current account has been balanced, and privatisation has not given advantages to foreigners. They were also not queuing; Slovenia’s market is small and labour relatively expensive.

On the other hand, high shares of FDI in GDP in the candidate countries have been considered a proof of success of transition and EU convergence and any doubts in this “self-evident fact” have been proclaimed a kind of nationalistic strangeness. Privatisation of production capacities undoubtedly assists in fulfilling Copenhagen criteria, and their sales to foreigners, particularly those from EU, are relevant for integration of the candidates into EU and EMU even before their formal inclusion. It is less obvious that macroeconomic effects of foreign takeovers are only positive, that they lower the balance of payments restrictions, and that they increase economic growth. Indeed, the negative spill-over effects of FDI (mainly acquisitions) seem to offset the positive direct effects.

Table 4 shows that average growth in the 1993-2001 period was lower than the share of current account deficit in GDP (with exception of Poland and Slovenia), that growth was very unstable (except in Slovenia) and that growth was highly correlated with current account deficit (foreign savings) in three Baltic countries.

Data in Table 5 indicate that sales of production capacities in the candidate countries have not sufficed to cover the current account deficits, these deficits have therefore cumulated into indebtedness. The relation between the stock of FDI in GDP and foreign debt in GDP (DEBT/GDP) is shown in Figure 1 for all eight countries for the period 1994-2001. Without an attempt of a causal analysis this strong relationship (correlation coefficient 0.71 is high for panel data) can be explained in two ways: (1) CA deficit and foreign debt request sale of production capacities or (2) sale of production capacities indirectly increases CA deficit and foreign debt. It is also possible that the causality functions both ways and that it alters over the period. For example; the proceeds from sales in the period of privatisation incre-

| Tab. 4: Growth and Current Account (CA) of Candidate Countries, 1993-2001 |
|-------------------|-------------------|-------------------|-------------------|
|                   | Growth X s        | CA/GDP X s        | correlation (growth-CA) |
| Czech R.          | 1.94 2.68         | -3.56 2.44        | -0.25              |
| Estonia           | 2.88 5.40         | -6.52 3.57        | -0.87              |
| Hungary           | 3.18 1.88         | -4.59 2.73        | 0.54               |
| Latvia            | 2.10 6.72         | -3.34 9.33        | -0.87              |
| Lithuania         | 0.36 7.78         | -7.66 3.43        | -0.82              |
| Poland            | 4.43 1.99         | -2.55 3.52        | 0.52               |
| Slovakia          | 3.53 3.04         | -5.11 5.10        | 0.03               |
| Slovenia          | 3.99 0.92         | -0.21 2.29        | -0.08              |

Notes: X – average, s – standard deviation

| Tab. 5: Foreign Debt and FDI stock in candidate countries (mil. US$ or %) |
|-------------------|-------------------|-------------------|-------------------|
| Czech R.          | 10694 22000 26.0 39.0 4547 26764 11.0 47.4 |
| Estonia           | 2309 5448 16.5 60.9 212 2122 9.2 38.9 |
| Hungary           | 28521 35485 68.7 69.0 7095 23562 17.1 45.8 |
| Latvia            | 825 5374 22.6 70.9 279 2644 7.6 34.9 |
| Lithuania         | 529 5236 12.4 43.8 31 2807 0.7 23.5 |
| Poland            | 43600 70080 47.1 38.9 3789 39000 4.1 21.7 |
| Slovakia          | 4660 11269 32.0 56.9 897 6000 6.1 30.3 |
| Slovenia          | 2258 6717 15.7 35.7 1326 3400 9.2 18.1 |

Source: EBRD Transition Report Update, May 2002;
WIWI: Research Reports, No. 283, February 2002;
ECE: Economic Survey of Europe, 2002/1, calculations.

Fig. 1: Foreign Debt and FDI stock
ased consumption of imported goods, CA deficit, and foreign debt which then created needs for more sales of production capacities.

FDI are explicitly and even more implicitly considered a kind of panacea for problems of transition countries which is indicated also by their efforts to get as much FDI as possible; the claim that FDI do not increase economic growth but rather diminish it seems at odds with economic logic. However, empirical data show exactly that. Slovenia, with relatively small FDI has had higher and very stable growth than countries with much higher FDI. However, the success of Slovenia can be explained by its much better starting position and one could claim that economic growth and convergence to EU would be even higher with more FDI. Therefore, the relation between FDI and economic growth for eight candidates for the period 1994-2001 was explored by the use of panel data. Results of the Granger causality tests have been surprising; one can at 1% risk reject the null hypothesis according to which FDI does not influence growth is incorrect.

Simple linear regression lines with growth (rGDP) as dependent and FDI independent variable are depicted on Figure 2. The regression line on the left shows dependence of growth in current year on FDI in the same year, while the regression line on the right shows dependence of growth in current year on FDI in the previous year. It is easily seen that the right line better represents the relationship and that the regression coefficients are significant. “Surprising” results can be explained by distortions which FDI have had on domestic economic environment. Namely, most of FDI in candidate countries have been acquisitions in manufacturing sector and “green-field” in trade sector. Two channels therefore seem to offer explanations. First, the proceeds from sales increase imports of consumers goods, and current account deficits which hinder growth in the short run. Second, by acquisitions production or business units are included into production and business systems of multinationals. This might have negative “spill-over” effects on the existing economic environment which can more than outweigh the increase of microeconomic efficiency of the sold production or business units. Namely, the increase of microeconomic efficiency results from changes in technology, specialization, and purchases of raw materials and spare parts within multinationals or from suppliers abroad thus cutting links with domestic suppliers and decreasing their production and employment. While these macroeconomic data do not suffice to confirm that take-overs in the previous decade diminished growth in transition countries, they nevertheless suffice to cast doubts on some of the “self-evidences” regarding FDI and growth.

The central role in the real and nominal convergence will be given to the exchange rate regime. In the nineties transition countries chose different exchange rate regimes from the most restricted such as currency board in Estonia to managed floating in Slovenia. Furthermore, most of transition countries have changed the regimes: the difference between Slovenia and Baltic countries indicate that choice of the regime was important; the three Baltic countries having the highest deficit and the least stable growth, while Slovenia has had far the lowest CA deficit and the most stable growth. While one should not overlook the starting position, many studies (Bole, 2002, Oplotnik 2002) indicate that the choice of managed floating regime by which central bank tried to prevent real appreciation of the Tolar was the pillar of stability and current account balance. Slovenia, indeed, has had relatively high inflation but inflationary mechanism and monetary policy transmission mechanism indicate that high inflation was due to other factors and not due to monetary policy. In short, Slovenia should retain managed floating with slow nominal depreciation and real appreciation which enable competitiveness as long as possible.

Should a newcomer insist on fast inclusion into EMU? Many arguments in favour (Balzerowicz, 2002) are based on a neoclassical approach; fast entry should speed up restructuring and liberalization of the labour market which should contribute to nominal convergence and shorten the period of uncertainty. The actual policy should however depend on the starting position at the moment of inclusion particularly on the sustainability of the “equilibrium” exchange rate.

Often expressed worries of the incumbent countries by which new members would
endanger the (stability of the) Euro are not justified; the real problems of the ECB monetary policy are elsewhere. It is true that the homogeneity of the enlarged EU will be lower and that asymmetric shocks will increase. This might also lead to disagreements with monetary policy of ECB, but rather more among incumbents than with newcomers. A much more predictable danger for the EMU is to be seen in the Pact on Stability and Growth. The EMU seems to be created for good periods of economic development and not for longer recession when economic policy must switch from monetary to fiscal measures. In short, one cannot completely ignore the possibility of a “Yugoslav scenario” in which everybody was “exploited” by everybody else.

References


---

1 The predominant part of systemic framework for an efficient market economy was created in 1990 and 1991, i.e. before political independence. Simple, transparent, and nondiscretionary system of direct taxes was introduced by Income Tax Law and Profit Tax Law. The statutes regulating monetary and financial system such as Law on the Bank of Slovenia, Law on the Banks and Saving Institutions, Law on the Foreign Exchange Transactions, and Law on the Rehabilitation of the Banks and Saving Institutions were passed together with the Declaration of Independence in June 1991. After independence, missing legal rules which guide economic behaviour (company law), assure a predictable bargaining framework (codes regulating business transactions), enforce rules, and resolve disputes (bankruptcy, competition) were added. In short, one might assert that proper legal framework for an efficient market economy exists.

2 The design of foreign exchange market in Slovenia described elsewhere (Mencinger, 1993) was influenced by the heritage of persistent shortages of foreign exchange which had prevailed in Yugoslavia. Various restrictions were therefore imposed on the foreign exchange markets. Most of them were abolished in 1992 when the abundance prevailed over shortages.

In 1998, Human Development Report was for the first time prepared for Slovenia: The Human Development Index which encompasses indices of economic development, health, and education and is used for international comparison, put Slovenia in 26th place among 194 countries which is 11 places above its ranking measured by GDP per capita.

3 The design of the Slovenian League of Communists in the 1980’s made it possible for Slovenia to become a forerunner in political changes in Yugoslavia; the stand of the Party on the issues of Kosovo, the fact that its delegates left the Yugoslav Party Congress in 1989, and withdrew from it in 1990 characterize its behaviour.

4 Freedom of people to move was a welcome political issue when Berlin and other walls prevented it, and rather annoying when free movement of labour could become a reality. Furthermore, incumbents have been afraid that enlargement would expand EU budget, present beneficiaries have rejected sharing subsidies with newcomers, or present benefactors have not been be willing to pay more. Economic moral appeared to be clear from the very beginning; it was less relevant whether CEECs can fulfil requirements, the real issue was whether EU can afford enlargement.

Granger Causality Tests

Sample 1:80 Lags: 1

<table>
<thead>
<tr>
<th>Null Hypothesis</th>
<th>Obs.</th>
<th>F-Statistics</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP does not Granger cause FDI/GDP</td>
<td>56</td>
<td>0.59072</td>
<td>0.44555</td>
</tr>
<tr>
<td>FDI/GDP does not Granger cause GDP</td>
<td>4.91794</td>
<td>0.03089</td>
<td></td>
</tr>
</tbody>
</table>

Sample 1:80 Lags: 2

<table>
<thead>
<tr>
<th>Null Hypothesis</th>
<th>Obs.</th>
<th>F-Statistics</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP does not Granger cause FDI/GDP</td>
<td>48</td>
<td>1.10682</td>
<td>0.33984</td>
</tr>
<tr>
<td>FDI/GDP does not Granger cause GDP</td>
<td>4.71209</td>
<td>0.01411</td>
<td></td>
</tr>
</tbody>
</table>

5 Similar "surprising result were for 14 transition countries in 1998 and FDI in 1997 found by Begg, Halpern and Wyplosz (CEPR, 2000)
1. Introduction

The accession of the GDR to the Federal Republic under Article 23 of the Basic Law on 3 October 1990 was not just the consummation of the unification of the state of Germany. On that date, for the first time, a state that had previously belonged to the “Eastern Bloc”, the system of the Warsaw Treaty and COMECON, was entering the European Union.

The obvious thing to do is to analyse and evaluate economic and social experiences in Eastern Germany in the period since 1990 in order to draw conclusions from it for the integration of the Central and Eastern European candidates (CEE countries) into the EU. For this purpose, however, the first question that needs to be answered is to what extent the experience acquired in Eastern Germany since unification is representative and usable for the CEE countries. This applies in particular to considerations of the differing and in part contrasting interests of the EU on the one hand and the individual candidates for accession on the other and as well as the way in which these interests are perceived, how they unfold and to what extend paths are taken towards solution or further accentuation and sharpening of the conflicts that underlie them.

The question of the validity of the experience of Eastern German development since 1990 for the preparation and implementation of the accession of the CEE countries to the EU cannot be answered with a simple yes or no. Rather the answer is ambivalent.

On the one hand there are a number of similar problems and challenges that are generally connected with the transformation into a capitalist market economy, integration into an economically stronger and superior environment and the dominance of the interests of the countries that are already EU members. Problems similar to those in eastern Germany after 1990 also have come up for the CEE countries from the close economic interdependence that developed between them in the period before 1990, which was abruptly broken off to a large extent after 1990 and has found no real equivalence to date.

On the other hand the conditions of accession of the GDR to the Federal Republic and its integration in the EU differ fundamentally in many respects from the conditions under which the CEE countries are presently preparing their accession to the EU or that will develop afterwards. This refers not only to the size and extent of the problems and the quality of the differences of interests and the way they manifest themselves but also and above all to the conditions, possibilities and time frames for unravelling and resolving the problems and conflicts.

2. Similar problems and challenges

Eastern Germany, the new federal states (“neue Bundesländer”), and the CEE countries faced or still face similar tasks and challenges, particularly in reducing the lack in productivity and in the economic structures in order to increase their international competitiveness, in transferring state property to new private and market economy structures and in the virtually total adoption of the economic and administrative law of the Federal Republic or of the EU (the “acquis communautaire”). Similarities and common ground are seen here in particular in the contradictory interests of the EU or the old Federal Republic on the one hand and the accession candidates or Eastern Germany on the other. The former, and this is of course true above all for the capital in those countries, are interested in using accession or enlargement primarily as expansion of the market, as the conquering of new sales territories for their companies, and for cutting production costs (low wages in the acceding countries). The interests of the people in the candidate countries, in contrast, are directed above all towards better economic frame conditions, especially towards receiving support from the EU for greater economic dynamism in their national economies. Creating jobs that can provide a living and are future-oriented, raising the living standards of the people and obtaining better market opportuni-
ties in the EU countries are in the foreground. It is characteristic both for Eastern Germany in 1990/91 and for the CEE countries today that only the complete adoption of the legal code of the FRG (old) or the EU was or is on the agenda, whereas benefiting from experience in the other direction, eg. in childcare or the health system, was and is ignored. While it is true that the privatization of state enterprises is already well advanced in most of the CEE countries, it has not yet been completed, unlike in Eastern Germany. The conflicts of interest between West German capital and the East German population became especially evident in the course of the restructuring of property relations in the new federal states. The dominance of West German capital interests was asserted primarily through the activity of the Treuhandanstalt, which was in charge of the privatization of the state enterprises. With very few exceptions, all management functions in this privatization body were filled by West Germans, who were often direct representatives of the interests of capital groups or companies. The high speed at which they had to privatize and the uncertainty of their prospects left the enterprises with few chances of adapting to the new conditions. Together with the hasty introduction of the Deutschmark and the in part obsolete state of the GDR economy, this was the decisive reason for the plunge in the East German economy in the years 1990–1991/92 (total economic performance by one third, manufacturing by almost two thirds), the mass bankruptcy of the enterprises and the loss of one-third of all jobs.

The bulk of the privatized, formerly state-owned assets (about 85% of fixed assets) ended up in West German hands and about 10% went to foreign shareholders. In many cases too the Treuhandanstalt was used to get rid of East German competitors. At the end of the nineties the share of West German and foreign ownership of the enterprises in East Germany was as follows: number of enterprises 13%; business volume or turnover 52%; subscribed capital 50–58%. This kind of privatization results in a degree of “outside ownership” of the enterprises in the region, especially the larger enterprises, but medium-sized ones as well, that is unparalleled among major developed industrial regions. Other results of this transformation of ownership were: the almost total disappearance of large-scale manufacturing enterprises; large parts of East German manufacturing became extended workbenches of West German enterprises; the skilled, value added-intensive functions–dispositional tasks–are concentrated in the West German parent companies. In this way, large parts of the East German economy were turned into a branch economy dependent on West German capital. This trend towards conversion of large parts of the manufacturing industry into extended workbenches of Western European enterprises exists in the CEE countries as well, and will probably be intensified after accession to the EU. It is true that this can safeguard jobs to a certain extent. However, it increases the dependence of the development of these enterprises on decisions made at company headquarters located in Western Europe. This makes them more crisis-prone as well. Future-oriented streamlining of the economy of the country or region using the existing strengths and experience and promoting regional integration relationships and company networks is acquiring greater importance for these countries, as for East Germany.

The safeguarding of the interests of the CEE countries against the powerful Western European capital groups demands that as far as possible, reinforced by East German experience, provisions be foreseen that prevent the total foreign infiltration of the economy through the dominance of Western European owners. The latter will always pursue their maximum profit interests and place them above the regional and national interests of the country where the plants are located. At the present stage of preparations for accession, however, there is very little scope left for such efforts.

East Germany and the CEE countries also have common or similar interests in at least selectively revitalizing the economic linkages that developed during 40 years of COMECON, and in making much more intensive and comprehensive use of the opportunities for close co-operation in the border regions (cf. the last section).

3. Fundamental differences between East Germany and the CEE countries

There are various reasons why the accession of the GDR to the EU cannot be compared to the accession to the EU of the CEE countries. On the one hand the GDR had a sort of special status even before 1990, since there were special arrangements for it in connection with inner-German trade. The GDR was exempted from the external tariffs of the EU countries. On the other hand, the GDR did not accede to the EU as a sovereign state. Its affiliation to the EU coincided with its accession to the Federal Republic, that is, with the end of its existence as a state, al-
though accession to the EU was already effected with economic and monetary union on 1 July 1990. Nor were there any preparatory period or any transitional provisions for the GDR, and this had negative consequences not only for manufacturing but for agriculture as well. Within a few days, for example, the market for food products and raw materials from domestic agriculture collapsed and they were replaced by deliveries from the Federal Republic and other EU countries. From one year to the next (1989 to 1990) their deliveries of products of the food and semi-luxury food, drink and tobacco industries to East Germany increased sevenfold.

A comparison between the accession of the GDR and the imminent accession of the CEE countries to the EU shows that the differences of interest between acceding country and EU had another quality as well. In the case of East Germany the differences of interest – owing to the simultaneity of accession to the EU and state unification – manifested themselves not primarily as conflicts between one country and the other EU countries but above all as internal conflicts within one country. They are mainly conflicts between the two parts of Germany, which had developed very differently in the 45 years between the end of World War II and 1990. Another aspect is of importance here: East Germany accedes to the larger Federal Republic, is integrated into it, and the scope and reach of the Basic Law and in principle all the laws of the old Federal Republic are extended to East Germany. It is annexed to a very efficient and internationally competitive economy, the strongest economic power in the EU. Accordingly, the interest problem even today is decisively determined by the specific manner in which unification took place – not as the unification of two equal states but as the GDR being taken over, pocketed, by the Federal Republic. It was based on an economic policy characterized by radical market policies and dominance of capital interests, with the ideology, policy and behaviour of the political class in the old Federal Republic towards everything that was GDR-specific, that were and still are strongly marked by ignorance and disapproval.

This contradictory mesh of conditions had the effect that the potentially far more favourable conditions in the new Federal States in comparison to the other so-called transformation countries did not work out sufficiently and were partly compensated by many negative effects.

Important aspects of East German economic and social development after 1990 are connected with this:

- The economic, property and legal order of the Federal Republic was foisted on East Germany without it having any time to adapt. Everything that showed traces of a socialist project was rigorously liquidated, and useful experiences and approaches to the solution of social problems were ignored. In the CEE countries, in contradiction to this, the attitude to the past and to the institutions and structures that emerged in that period has so far been less black and white.

- West German, which in this connection means “outside”, interests dominated in all important decision affecting East Germany. This was apparent not only in the privatization of national property by the Treuhandanstalt and in the way the capacities of the privatised enterprises were used but in other areas as well, for example in the discrimination against the agricultural co-operatives and in the treatment of the so-called old debts of the formerly state-owned enterprises, the co-operatives, the housing societies and even the municipalities.

- The East German elites were almost entirely removed from top positions in society, politics and government administration, in the economy, in science and culture and replaced with West German personnel who often had less skills and competence.

- The introduction of the Deutschmark was linked to the conversion of current expenses and current receipts from GDR Mark to Deutschmark at the rate of 1:1. This extreme upward revaluation was a shock to the GDR economy, and in the absence of protective and transitional measures it resulted in the loss of economic viability for many enterprises. In contrast to this real upward revaluation, the national currencies of the other CEE countries underwent a substantial devaluation vis-à-vis the Deutschmark and the Dollar in the nineties. This made the terms of competition more favourable for their enterprises than for East German firms on the domestic and especially on the international markets. Most of the currencies of the CEE countries were devalued far more than the actual purchasing power relationships would justify; they were and are undervalued in real terms. This is also shown by GDP per head comparisons based on currency exchange rates, in which these countries fare much worse than in comparisons based on purchasing power parity. In the year 2000 the average GDP per head, measured in purchasing power standards (PPS), for the accession candidates (including Malta and Cyprus) was...
44% of the EU average (Deutsche Bundesbank, monthly report 10/01: 21). A comparison based on current exchange rates yields a GDP per head of population that is only slightly over 20% of the EU average. Accession to the EU will do little to change these relations in the short term. Immediate accession to the monetary union would be disastrous both for the countries joining and for the present members. Even after joining the EU the CEE countries would have to dispose of an adaptation instrument based on flexible exchange rates, which is important for keeping their exports competitive for several years before joining the European Monetary Union. However, further steps towards devaluating their currencies in order to improve the export chances of their goods and services would mean increasing pressure on domestic prices and an increase in the cost of living.

- The application of the wage-rate system of the Federal Republic in the new federal states and the relatively big steps taken in the first few years to bring wages in the East into line with those in the West increased the income and living standard differential between East German employees and those in the other former socialist countries of Europe. The application of the social insurance systems of the Federal Republic to East Germany had a similar effect. In this way it was possible to ensure a much higher level and greater stability of unemployment assistance, pensions and other employee benefits than would have been possible in an independent state under comparable conditions. Since the requisite benefit payments for the East German unemployment, health and pension insurance come not from tax revenue but from the social insurance funds themselves, the result was higher contributions for employees and firms in West and East Germany to these assurance systems. The lion’s share of the burdens arising from unification was shouldered by the employees. Even 12 years after unification, however, income and comparable social benefits of the East German population are still well below the West German level. On average, gross hourly earnings in East Germany in the year 2000 amounted to 70% of those in West Germany. Owing to the longer average working hours, average gross monthly earnings stood slightly higher, at 73% (Memo randum 2002: 248). The relative level of total disposable income per inhabitant is slightly higher than wages; in 2001 it stood at 83% (IWH Wirtschaft im Wandel 9/2002: 258). The social cash transfers that comprise the bulk of all West–East cash transfers are a direct consequence of Article 72 (2) of the Basic Law, which calls for the “establishment of equivalent living conditions” on the entire federal territory. The total net West–East public cash transfers amounts to about € 70 billion a year. About three quarters of the cash transfers stem from legal provisions that apply to the whole Federal Republic, i.e. only one quarter or about € 20 billion result from special provisions to support East Germany.

- Substantial public funds were used to promote business investments in East Germany, to modernize the traffic and communication systems and as grants to the states and municipalities which were also used for investments in developing the infrastructure and in housing construction. All this led to an unusually high (by international standards) proportion of “outside” sources of funds for investments. Investments in the new federal states from public and private West German and foreign sources amounted to an average of € 50-60 billion per year between 1991 and 2000. During these ten years they amounted to a total of at least € 500 billion. Total foreign direct investments in all Eastern and Central European countries in the period from 1991 to 1999 amounted to about € 70 billion. They increased more than threefold from 1994 to 1998 and totalled 10.3 billion Euros in 1999 (IW Köln, IWD 30/2001). That means that in an average year in the nineties about six times as much money from “outside” sources was invested in East Germany as in all other former state socialist countries taken together in 1999.

The coincidence of the transformation process with the unification process is the decisive reason for the different quality of the conflicting interests between East Germany and the Federal Republic of Germany (FRG) and the EU on the one hand and the CEE candidates for membership and the EU on the other. The evaluation of these differences can be summarized as follows:

1. As part of the Federal Republic, East Germany has far more favourable preconditions than the other CEE countries for increasing individual incomes and improving the material standard of living, for modernizing and expanding the infrastructure and for renewing fixed assets in the economy through investments.

2. The dominance of the interests of capital and the political class of the Federal Republic (old) was overwhelming and almost uninterrupted in all
decisive areas. The main reasons for this were (1) that the socialist experiment in the GDR had failed and the GDR rulers had lost the support of the population; the Federal Republic had been the winner in the competition between the two German states; (2) that the Federal Republic was economically a far more powerful state, with an internationally highly efficient economy; (3) that the population of the GDR had no real equal representation even in the last months before unification in October 1990 and had no specific representation of their interests at all after unification. That East German interests were nevertheless taken into consideration to some extent in federal policy is not only due to the constitutional principle of equivalent living conditions. The endeavours of the big political parties to win the East Germans as voters was also a substantial factor.

3. The economic and social development up to now in the new federal states, notwithstanding the major gains that have doubtless been made in important fields, is still lagging far behind the expectations of the East German population and the promises made by both the Kohl government and the red-green government under Schröder. The huge gap between the substantial investment of funds and material resources in East Germany and the results achieved is due largely to politics. Basically the transformation took the form of a negation of the existing social institutions in the GDR, without retention and utilization of their potential for progress in resolving the problems. When the GDR was affiliated, a major territory in which 16.5 million people lived, one that had developed in a specific way over an extended period, was totally integrated into the existing property and capital structures and legal and institutional structures of the old Federal Republic. Combined with almost blind faith in the market and a dogmatic privatization strategy, this type of affiliation led to the destruction of significant economic, scientific and technical potentials, the creative capabilities, specialized skills and experience of millions of people being left fallow and devalued. Public ownership had to be precluded; reflections about economic reform were brushed aside and a public debate on appropriate ways of resolving the complex problems, which could have fostered a learning process, was prevented.

The failure of economic policy becomes clear when one considers the various stages of the economic development of East Germany: The first stage (1990-1991/92) can be described as the dismantling or downfall of the East. The gross domestic product dropped to 60% of the 1989 figure, and industrial production fell to one third. There are hardly any large industrial enterprises left—out of 840 enterprises (in 1989) with more than 1000 employees: only 117 still existed in September 1992. In 1989 there were 9.7 million profitably employed persons in the GDR. Three years later, only 6.4 million people were still profitably employed in the new federal states and East Berlin. The research potential shrank to one fifth. In agriculture and forestry the number of persons profitably employed dwindled even further than in manufacturing, to just over one fifth.

In the second stage (1992-1995) a temporary dynamic growth process reduced the gap between the new and old federal states in terms of productivity, GDP per head, provision with modern infrastructure and the income and consumption level of the population. A considerable proportion of the old manufacturing plants was renewed or new production capacities were created during this stage. This “catching-up stage”, with annual GDP growth rates 3–4 times of those in the old federal states, was based primarily on extensive investments in the infrastructure and renewal of manufacturing plants, brought about in particular through business and especially investment incentives. The building trades and the services were mainly responsible for the growth in GDP in this stage. Gross value added (GVA) in the building trades increased by 84% between 1992 and 1994 (a yearly average of 22% in those three years). The GVA in the building trades exceeded that in the manufacturing industry by almost 50% in 1995 (€ 31.7 billion compared to € 21.6 billion at 1995 prices).

This temporarily disguised and pushed into the background certain inhibiting factors without doing anything to change the fundamental problems of East German economic development. In this stage as well, however, investments and economic growth had little positive influence on the development of employment. There were 90 000 less wage and salary earners in 1995 than in 1992, and the number of profitably employed persons was virtually unchanged (just 0.2% higher).

The relative economic dynamism in this stage is closely interlocked with two factors: the preceding sharp plunge and the large share of outside sources. The latter circumstance is ambivalent. It has been and is decisive for the rapid rate of renewal and extension of the infrastructure and urban and hou-
suing redevelopment – high construction rate – and the modernization of manufacturing plant. At the same time it is one more reflection of the high degree of dependence on outside economic and other influences.

1996/97 was the start of the third stage, in which the “catching-up process” was not just interrupted, did not just “stagnate” as the official reports usually put it, but was aborted. From 1997 to 2001, for five years in succession, the GDP growth rates in the East were lower than in the old federal states. In 2002 as well, there will presumably be less growth in the East than in the West. The lack of economic dynamism since 1996 could not be disguised either by the higher rates of growth in manufacturing, since on the one hand its share in GVA is still relatively small and on the other hand building industry production has steadily fallen since 1996. Only 43 out of every 1000 inhabitants are employed in East German manufacturing as opposed to 86 in West Germany (2000). In 1989 the figure was 150. By 2001 the GVA in the building industry had fallen to 63% of the 1995 volume. In that year the there were only 5.8 million profitably employed persons left in the area of East Germany. This was 250 000 less than in 1995. The number of wage and salary earners dropped even more sharply, by 300 000. This downward trend was seen in investments as well. Fixed asset investment (at 1995 prices) reached its maximum of € 99.4 billion in East Germany in 1995. It declined steadily in all subsequent years, reaching € 72.7 billion in 2001 (IWH, 9/2002: 260).

It is hard to say with certainty at this time to what extent the new states will manage to introduce a fourth stage in which they will be able to approach the overall economic productivity of West Germany and the GDP growth rates will again be slightly higher than in the old federal states. The only thing that is certain is that if the East ever does have a growth advantage, it will not be great. Assuming a 1% higher growth rate (West 2% and East 3%) – if the proportion of the population living in East Germany remained the same – the relative level in GDP per head would only rise from 60% in 2000 to 67% in 2010 and 73% in 2020.

A future catching-up process in East Germany is primarily dependent on three basic conditions:

1. The internal resources and potentialities have to be strengthened and at the same time supplemented over an extended period and to an adequate extent by outside resources and sources above all for investments and R&D capacities.

2. Through more efficient promotion of trade and industry and a future-oriented economic and above all regional structural policy, the available resources must be co-ordinated and deployed with greater efficiency for added value. Innovative and ecologically sustainable structural development, the generation and development of regional circular flows and linkages, the generation and promotion of networks of enterprises and regional production clusters and the creation of viable jobs, especially in manufacturing and high-quality services, are the priorities.

3. The endogenous production potentials to be developed have to be turned into innovative, marketable goods and services and, on that basis, into larger market shares. The expansion of the market takes on a key function. The expansion of supra-regional (export) deliveries is particularly important.

Table 1 summarizes common features and differences between East Germany and the CEE countries in terms of EU accession.

4. Problems of eastern enlargement from the viewpoint of the CEE accession countries and from the East German viewpoint

Up to now the question of interests has been considered above all from the point of view of the relations between the new EU members (CEE candidates and East Germany) and the previously existing EU or the previously existing federal territory. In the following the differences and common ground in the interests of East Germany and the CEE candidates for membership will be in the foreground.

The specific presentation of the East German viewpoint is of particular importance in studies of the generally differing perception of EU enlargement from the western and eastern viewpoints. It is based on a role of East Germany in the eastward enlargement of the EU that differs from that of all other regions of the EU and is in some respects a dual role.

On the one hand, East Germany as a part of the Federal Republic of Germany is affected in the same way as all the other countries and regions of the present EU by the changes connected with enlargement. The changes in such areas as business incentives, deployment of funds for the common agricultural policy, mobility of capital and the free movement of labour naturally have a strong impact on the interests
East Germany has more common ground and interests in common with the candidates for membership. This applies to the similar problems that need to be solved in the transformation to a capitalist market economy. But it applies equally to a common interest in a type of development that, firstly, carries on from experiences of social justice and equality that are worth retaining, secondly, revitalizes past economic links, to the extent that that is still feasible today, and thirdly, rests on common concepts for the border regions that give adequate consideration to the specific interests of the partners.

East Germany also has a direct interest in the economic success of the CEE countries. Only then will East Germany have any prospects of using the opportunities of dynamic export development and intensification of economic linkages that EU enlargement offers and to minimize the great risks of East Germany as well.

### Tab. 1: Common ground and differences between East Germany and the CEE candidate countries in connection with accession to the EU

<table>
<thead>
<tr>
<th>Common ground /similarities</th>
<th>Differences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common historical background of post-war development until 1989/90; membership of COMECON, Warsaw Treaty</td>
<td>For the GDR the transformation from socialism to a capitalist market economy coincided with accession to the FRG and the EU; Accession to the EU came at the beginning of the transformation; the accession of the CEE countries comes almost 15 years after transformation.</td>
</tr>
<tr>
<td>Prerequisite for accession: adoption of capitalist market economy structures</td>
<td>GDR joined the EU not as an independent sovereign state but as part of the Federal Republic, CEE countries will join EU as sovereign states.</td>
</tr>
<tr>
<td>Accession linked with adoption of the legal code of the EU, the acquis communautaire. Only one direction of change with EU enlargement, from west to east</td>
<td>With accession to the Federal Republic the existing elites in the GDR were removed in practically all fields and in large measure replaced by West Germans: such a removal didn't take place in the CEE countries.</td>
</tr>
<tr>
<td>Dominance of the interests of the Federal Republic (old) and the existing EU in the concrete provisions for accession</td>
<td>The GDR acceded to the FRG and the EU practically without any preparatory period and without any transitional arrangements.</td>
</tr>
<tr>
<td>Entry into an economically stronger state (FRG) or economic bloc (EU) with a substantially higher overall economic productivity and superior competitiveness</td>
<td>Not only were ownership structures changed through privatization on accession but the bulk of the privatized formerly state-owned enterprises became the property of West German firms; therefore the interests of West German capital exert a decisive influence.</td>
</tr>
<tr>
<td>Accession is linked to financial support from the EU Structural Funds for approximation of the levels of economic performance to the EU average</td>
<td>As part of the Federal Republic and as a consequence of the application of the Basic Law, East Germany benefits from substantial cash transfers that are used primarily as social transfers for consumption purposes and for the infrastructure (fiscal equalization among the states, Solidarity Pact I and II); such funds will be available to the CEE countries neither for social nor for investment purposes.</td>
</tr>
<tr>
<td>The former close economic relationships of the GDR and the CEE countries among themselves no longer exist; foreign trade is oriented towards different markets</td>
<td>Unlike in the CEE countries, a process of deindustrialization and liquidation of enterprises unparalleled in history took place when East Germany joined the FRG and the EU; in the CEE countries far-reaching structural adaptation processes - including tendencies of deindustrialization - have already taken place prior to accession.</td>
</tr>
<tr>
<td>Economic performance declined more or less sharply after 1990 and in some countries - including East Germany - it has just or still not regained the 1989 level</td>
<td>The GDR’s accession to the Federal Republic and the EU was linked with the introduction of the Deutschmark (in fact it was introduced on 1/7/90, three months before state unification) and with a concomitant upward revaluation shock, while in the CEE countries export positions were improved by devaluation of the currencies and even after accession to the EU the exchange rates will remain flexible for several years within a range yet to be determined.</td>
</tr>
<tr>
<td>For East Germany labour mobility existed from the beginning; the strain on the East German labour market is relieved regionally in various ways through &quot;job commuters&quot; and &quot;migration&quot; to the old federal states; since it is mostly the young and highly skilled who leave, this has negative consequences for the future of East Germany</td>
<td>For East Germany labour mobility existed from the beginning; the strain on the East German labour market is relieved regionally in various ways through &quot;job commuters&quot; and &quot;migration&quot; to the old federal states; since it is mostly the young and highly skilled who leave, this has negative consequences for the future of East Germany.</td>
</tr>
</tbody>
</table>
that certainly exist.

An EU enlargement that is beneficial both to the present EU and to the acceding countries can be promoted if East Germany exercises its potential function as a bridge between the EU and the new member countries.

One major problem that will affect the future development of the EU and the new member countries is the development of financial resources and specifically the resources for the structural and cohesion funds. The shifting of financial and other economic responsibilities to a supranational level that takes place in the EU, unparalleled in other regional economic blocs, could also be a contribution to more effectively promoting the reduction of the development gap between Western and Eastern Europe. To achieve this, however, certain conditions will have to be fulfilled: strengthening and further developing the institutional prerequisites, e.g. those of the Ecofin Council, improvement of co-operation among the institutions, co-operation between monetary policy directed by the ECB, fiscal policy and labour-market policy and enhancement of their democratic authority. Another necessary condition, however, is the strengthening of the financial potential of the EU earmarked for this purpose. It is necessary to take full advantage of the present upper limit of the EU budget, 1.27 per cent of GDP, and to take further steps to substantially increase the budget. This is the only way preconditions can arise for the requisite financial conditions to be created for the present EU regions with major problems and at the same time the new member countries, which are all far below the EU average in GDP per head. This is not planned, however, and is opposed above all by the government of the biggest net payer, Germany.

In terms of GDP per head (calculated on the basis of parity of purchasing power) only three of the ten candidates for membership had a ranking in the year 2000 of 50% of the average of the EU 15 or more: Slovenia 71 per cent, Czech Republic 60 per cent, Hungary 51 per cent. The other seven were well below 50 per cent. By way of comparison, the level of the new federal states was about 70 per cent in the year 2000. The enlargement of the EU by ten countries would mean a decline in the present GDP per head of the population in the EU by about 13 per cent. This would have considerable consequences for all those regions that presently receive the maximum grants as EU Target 1 Regions according to the criterion of GDP per head < 75% of the EU average. Of the 60 EU Target 1 Regions, 29 would no longer qualify for these grants, including seven of the nine Target 1 Regions in East Germany (IWH, 9/02: 267). Between 2000 and 2006 the East German states (excluding Berlin) will receive € 20 billion in Target 1 Region grants, which is about € 3 billion a year, 80% of which would then be discontinued. East German interests are of course greatly affected by this.

Since the development deficits and problems are much greater for almost all the candidates for accession than for the countries that up to now have been at the tail end of the EU in GDP/inhabitant, more resources per inhabitant than hitherto ought actually to be deployed for the countries acceding. Under existing plans, however, the opposite would happen: the funds available would be considerably reduced.

The demand for the provision of more financial resources for the structural funds thus has primarily to do not so much with differing interests in Western and Eastern Europe as with the necessary assertion of the common interests of the Eastern European countries and the Western European regions that lag far behind in development, especially in East Germany, Spain, Portugal, Italy and Greece, against the interests of the economically most powerful Western European countries.

Another problem that will be important for East Germany arises from the increase in the mobility of capital with accession to the EU. Although most of the candidates for membership have already succeeded in implementing liberalization to a large extent, capital flows will be further facilitated when the EU expands. This can effect East German interests, e.g. if a larger proportion of the not-so-numerous potential investors than hitherto invest not in the new federal states but beyond the borders in the neighbouring countries. Actually it is not a fundamental conflict of interests between East Germany and its eastern neighbours that is involved here. Stable expansion of economic, scientific and technological co-operation and of commercial relations between East Germany and the acceding countries will only be possible if the economic potential, capacities and markets on both sides of the borders develop dynamically. For the time being, however, sharper conflicts and the clash of different interests can and will occur.

No other aspect of EU eastward enlargement has been so fiercely and contentiously disputed as the free movement of labour and the related issues of freedom to provide services and to locate. This is no accident, since widely differing interests and standpoints clash here:
- Different interests of the acceding countries on the one hand and the present EU members on the other. Germany and Austria in particular are affected by this substantially more than the countries lying further west and further south. But they have also profited much more up to now from the opening up of the markets of the CEE countries.

- The interests of business, of the entrepreneurs/employers on the one hand and the wage and salary earners and their organizations, the trade unions, on the other. Here too there are also differences between border regions and more remote regions, different branches of industry and of qualification-groups of the employees.

- Defending primarily the presumed national interests of Germany is contrary to the postulate of a new social and democratic quality of European integration that is based on equal basic rights and freedoms for all men and women in the new Europe and shuns discrimination.

- To make matters worse, there are no reliable data on the extent of migration after the accession of the CEE countries and the resulting effects on the labour market in the receiving countries.

In large sections of the population of Germany and Austria in particular, and more especially of course in the East German regions with well above average unemployment rates, there are strong misgivings about the likely negative effects of free movement of labour – worse employment prospects, greater pressure on wages – that have to be taken seriously. The aspect of the free movement of labour that predominantly is being discussed is that of transitional arrangements. In the course of the first six months of 2001 the EU laid down its position on these problems for negotiations with the candidates for membership, influenced in particular by Germany and Austria. It provides for the application of transitional time limits for the implementation of free movement of labour, the maximum term being seven years. An initial review is to take place after two years. The new EU members are to have the opportunity to apply for earlier abrogation of the time limit. The time limit is to be extended from five to seven years only in the case of “serious disruption” of the labour market. If a country has opened its borders for wage and salary earners prematurely it can have recourse to escape clauses in the event of crises.

Free movement of labour is a complex and contentious matter and not without risks. The following should be considered when defending a standpoint on this matter.

1. The principle of free movement is a thread running through the whole agreement on the EU. It finds a prolongation in particular in the Charter of Fundamental Rights promulgated in Nice. Only serious grounds can justify a temporary limitation of this fundamental right of free movement. It must be borne in mind before reaching a decision that many people in the acceding countries regard the free movement of labour as the most important result of their accession to the EU and see it as an expression of whether they are being treated as equal members or as second-class citizens.

2. The fears of people in the border areas of East Germany that the already precarious labour market situation will be further aggravated by free movement of labour can be seen in perspective when examined more closely. Those hoping to find employment through migration are unlikely to focus on the regions with the highest unemployment rates, few chances of employment and low wages. For the underdeveloped border regions as well as for other regions the granting or limitation of freedom to provide services is of greater importance than free movement of labour. Unregulated freedom to provide services can lead to a sharp increase in the sending of employees to work in foreign sub-contracting firms that practice wage and social dumping and to displacement effects in local labour markets. However, this is not just a problem of eastward enlargement. Further action is needed, now that a start has been made with the deputation sending arrangement (EU Guideline and German Employee Deputation Act) to close existing gaps.

3. Limitation of free movement encourages illegal employment and the shadow economy. This increases the pressure on foreign workers to place themselves at the mercy of ruthless entrepreneurs. Thus free movement of labour, if the requisite legal conditions are provided and enforced, operates as a means of counteracting illegal employment and the shadow economy.

4. Regardless of what one thinks of transitional time limits affecting the free movement of labour, it should be possible for all those interested in a socially-minded, future-oriented Europe to agree on the following:

(a) The real reason for the problems and anxieties that exist in connection with free movement of labour in East Germany is not eastward enlargement but the current high rate of unemployment, the spread of precarious employment relationships and the undermining of the collective wage
agreement system in the new federal states.
(b) A transitional period alone will not solve any
problems. Substantial wage differentials will still
exist in five or seven years. The decisive contri-
bution will have to be made by a cooperative
structural and employment policy on both sides of
the borders and spanning the borders, with the
purpose of defusing the economic, social and
labour market problems.

References
Arbeitsgruppe Alternative Wirtschaftspolitik, MEMO-
RANDUM 2001, Cologne 2001
Brie, André, Gegensätzliche Befürwortungen der Oster-
weiterung, in: Rosa-Luxemburg-Stiftung, Manuskripte 11,
Berlin 2001
Cyrus, Norbert, Stellungnahme zu der öffentlichen Anhö-
rung des Ausschusses für Angelegenheiten der Europäi-
schen Union des Deutschen Bundestages am 4.4.01: EU-
Erweiterung und Arbeitnehmerfreizügigkeit
DGB Bundesvorstand, Die Umsetzung der EU-Struktur-
fonds in den neuen Bundesländern 2000-2006, Berlin
2001
Dieter, Heribert, Ansätze für Reformen des internationalen
Finanzsystems, Manuskript, Jahrestagung der Otto Bren-
er Stiftung 2001, Panel I, IWF und Weltbank – zwischen
Beharrungsvermögen und Reformnotwendigkeit
Dräger, Klaus, EU-Osterweiterung und Freizügigkeit für
Arbeitnehmer und Arbeitnehmerinnen, Manuskript 2001
Erklärung und Memorandum europäischer Wirtschafts-
wissenschaftlerInnen (Euromemo), Vollbeschäftigung und
eine starke Sozialverfassung – Alternativen für eine Neue
Ökonomie in Europa, in: MEMO-Forum, Zirkular der
"Arbeitsgruppe Alternative Wirtschaftspolitik", Bremen
2001
Faude, Eugen/Watzeck, Hans/Fenske, Kurt, Eine kritische
Betrachtung des EU-Beitritts der Länder Mittel- und Ost-
europas aus linker Sicht, Auftragsstudie der GUE/NGL-
Fraktion des Europäischen Parlaments, in: Rosa-Luxemb-
burg-Stiftung, Manuskripte 11, Berlin 2001
Heine, Michael/Herr, Hansjörg, Das Eurosystem: Eine
paradigmenorientierte Darstellung und kritische Würdi-
gung der europäischen Geldpolitik, Auftragsstudie der
GUE/NGL-Fraktion des Europäischen Parlaments, Rosa-
Luxemburg-Stiftung 2001
Institut der Deutschen Wirtschaft Köln, iwd 30/2001
Modrow, Hans/Hiksch, Uwe/Stobrawa, Gerlinde, Thesen-
papier zur Konferenz der Fraktion Vereinigte Europäische
Linke/Nordische Grüne im Europaparlament am 15. 9. 01
in Frankfurt/O, Grenzregion – Für ein solidarisches Euro-
pa
Rosenfeld, Martin T. W./Kronthaler, Franz, Konsequenzen
der EU-Erweiterung für die Regionalförderung in Ost-
deutschland, IWH, Wirtschaft im Wandel, 9/2002
Weise, Christian, EU-Osterweiterung finanziert –
Reformdruck wächst. Szenarien für den EU-Haushalt
2007 und 2013, DIW-Wochenbericht 36/01
Weise, Christian, Wohlstandsgefälle in der EU-27 und
Konsequenzen für die EU-Strukturpolitik, DIW-Wochen-
bericht 36/01
Währungspolitishe Aspekte der EU-Erweiterung, in:
Monatsberichte der Deutschen Bundesbank, Oktober 2001
The Hungarian way to the European Union

1. EU accession as a national priority

“Return to Europe” was one of the most widespread slogans of the 1989 political upheaval in Hungary (Andor 2000: 1). It became common sense that the fall of the Yalta system can only lead to a reunification of Europe, and that would happen under the umbrella of the European Union. From the earliest period of the transition, Hungarian politicians took it for granted that the country has a realistic chance to gain membership in the European Community (later Union). This became a core objective of Hungarian foreign policy, shared by all parliamentary parties between 1990 and 1998.

Mainstream economists supported this political endeavour by explaining the assumed advantages of EU accession as follows:

1. additional resources for the economy, i.e. working capital, loans and aid,
2. contributions to the financing and modernization of agriculture,
3. foreign direct investment by Western multinational corporations,
4. a growth in tourism and the foreign employment opportunities of the labour force, and
5. guaranteed security under the umbrella of NATO, which is apparently associated with EU.

Though a guarantee for full membership was not yet given, these expectations made the Hungarian government, the first out of the East Central European former socialist states, to sign an association agreement with Brussels. This was a programme of establishing a free trade zone in ten years, though some major areas like agriculture were left out of the package. The agreement re-confirmed the continuation of a minor economic aid package (PHARE) to assist the market reforms and the transition. The first time the EU actually declared that the associated countries could become full members was in 1993 June in Copenhagen. In the following years, the Brussels bureaucracy collected all possible information about the economies, societies and politics of the region. As a result of the so-called screening process, the EU named five former socialist states as candidates of membership in 1997.

Hungarians have been the most enthusiastic nation in Central Europe in terms of EU enlargement. Throughout the second half of the 1990s, a steady two-thirds majority of the people clearly supported the idea of EU accession. The causes for this positive attitude are several. It partly derives from the historical endeavour of the Hungarian nation to belong to the Western community. On the other hand, however, it also shows the success of the pro-Western economic elite groups that have benefited the most from the hitherto integration and proved very efficient in influencing the public debates and opinion on international economic issues.

2. Economic trends

2.1. Privatization and economic growth

Since the privatization process began in 1989, more than 1,000 state-owned companies have been fully privatized, bringing in revenues of more than USD 10 billion. At just over USD 1,000 of revenue per capita, Hungary is well ahead of other emerging markets and on par with the more developed United Kingdom. More than 80 per cent of the economy is now in private hands, with almost 90 percent of small enterprises privatized. Due to this process only few investor opportunities remain, with the exception of a few large diversified companies and remaining sales of shares in utilities.

The privatization of major utility companies resulted in an acceleration of large-scale privatization in the years 1995-96. By the end of June 1998, only 228 companies remained in the hands of the State Privatization and Holding Company (Állami Privatizációs és Vagyonkezelő Rt, or ÁPV). Out of these firms, just under 100 companies will remain at least partially in state ownership, because the state will retain a minimum holding in companies of basic national importance.

Multinational companies are present in most sectors of the Hungarian economy. In recent years, many have expanded their operations by increasing production capacity and, in a number of cases, establishing research and development facilities. The latter take advantage of the nation’s skilled and educated labour force, which is competitively priced in comparison with West European pay levels.

From the point of view of economic performance, the decade of transition can be broken down into
three different periods. In the first third, the country went through a 20 per cent decline in GDP. The central period can be characterised by a hesitant restart of growth, and the late 1990s experienced a reconstruction based mainly on manufacturing. This dynamism continued in the early years of the new century. Strong external demand boosted economic activity in 2000, allowing Hungary to post the strongest overall performance in the region and maintain its position at the forefront among the EU accession candidates. Real GDP grew by 5.2 percent in 2000. While exports functioned as the engine for growth, domestic demand growth remained moderate, reflecting slow real wage growth.

Robust economic growth, however, has been accompanied by signs of bottlenecks in skilled labour. Employment rose by 1 percent in 2000. The unemployment rate fell by ¾ percentage point to 6 percent (seasonally-adjusted) by end-2000 and was less than 3 percent in the Budapest area. Higher-than-expected inflation kept the gain in real net wages to 1.5 percent (year average) in 2000, which caused serious social tensions, because the employees did not receive any substantial gain from economic growth. Despite a world economic slow down in 2001 and 2002, Hungary continued to have a growth rate 2 per cent higher than the EU average. Accordingly, the level of unemployment has been below the EU-average in the recent years, though the level of employment is also well below EU norms.

2.2. Inflation and equilibrium

During the reconstruction period of the late 1990s, the rate of inflation came down markedly from the local peak of 1995, when the crawling band exchange regime was introduced. However, progress with disinflation in the years 1999-2001 turned out to be disappointing. Average inflation for 2000 - at 9.8 percent - barely budged from the 10 percent recorded for 1999 and was well above the government’s target range of 5-7 percent. The reversal of the disinflation trend in mid-2000 initially reflected exogenous supply shocks – including higher world oil prices and the weaker Euro. At the same time, core inflation was also rising, reflecting in part an increase in unprocessed food prices as a result of growth in external demand, but also the fact that domestic factors have been increasingly at play.

In the recent years, monetary and exchange rate policies have had to cope with the competing challenges of inflationary and capital inflow pressures. Early in 2000, heavy capital inflows kept the Hungarian forint at the strong edge of its narrow band, forcing the central bank to cut interest rates. By mid-2000, interest rates had been cut by more than 300 basis points, while the monthly rate of crawl was cut only once, from 0.4 percent to 0.3 percent in April 2000. This loosening of the monetary stance occurred against a background of a rekindling of inflation, a tight labor market, and strong economic growth. When capital market pressures subsequently cooled and in response to an unforeseen jump in inflation in September, the National Bank of Hungary hiked its key policy rates by one percentage point. In the first two months of 2001, amid a steady uptrend in core inflation, capital inflows prompted the central bank to cut rates twice-totaling 50 basis points. With a view to tightening monetary conditions, the monthly rate of currency devaluation was lowered from 0.3 to 0.2 percent from April 1, 2001.

These developments were followed by the introduction of a new exchange rate regime. On May 4, 2001, to give monetary policy more room for manoeuvre to better fight inflation and to take a first step toward conformity with ERM-II, the crawling band was widened from ±2.25 percent to ±15 percent. At the same time, the National Bank of Hungary proposed to accelerate the capital liberalization process through relaxing the restrictions on short-term capital flows and derivative transactions between residents and non-residents. A few months later the crawling of the exchange rate was completely eliminated and the forint was fixed against the Euro. The wide band, however, allowed the forint to appreciate by about 10-12 percent in the next year. By the end of 2002, the exchange rate was pushed to the upper limit by the monetary austerity applied by the National Bank to counterweight fiscal imbalance. The widened exchange-rate band and the appreciation of the currency significantly jeopardize the competitiveness of the small and medium companies. Furthermore the lack of the financial knowledge (hedge techniques, the products of the futures, forward markets) of the economic actors could cause serious problems when the exchange rate has a great fluctuation (e.g. the effects of a financial crisis somewhere in the emerging world – Turkey).

The general government deficit was successfully kept under control in the growth period of the late 1990s. By the year 2000 came in at 3½ percent of GDP, in line with the government’s deficit target. The subsequent years, however, brought a progressive loosening in fiscal policy. The right wing government tried to hide the emerging deficit by various techniques, but the new government in 2002 had no choice but introduce EU standards and try to
create a clean sheet. All that resulted in the rise of the budget deficit to more than 9 percent of the GDP in 2002.

The current account showed a similar trend in the same period. External competitiveness remained strong, with the external current account deficit narrowing in 2000. Industrial labor productivity - up by almost 17 percent in 2000 - far outpaced real wage gains, leading to a depreciation in the real effective exchange rate (based on unit labor costs) over the year. Rising export market shares and strong corporate profitability in the export sector also support the assessment of solid competitiveness. During most of the year, export growth exceeded that for imports, tourism revenues boosted the services account, and fiscal policy was tighter-than-budgeted, contributing to an improved external position. Thus, despite the worsening of the terms of trade, the external current account deficit narrowed to 3.3 percent of GDP in 2000, down from 4.4 percent a year earlier. However, the current account deficit started to grow again in both 2001 and 2002.

With credit ratings approaching advanced economy levels, Hungary maintains ready access to external financing - but external debt levels remain high. Spreads on sovereign benchmark bonds are among the lowest in the region, and, attracted by Hungary’s strong economic fundamentals and convergence prospects, foreign investors’ share of holdings of forint-denominated government securities reached record highs. However, in contrast to 1999, strong net FDI inflows were more than offset in 2000 by substantial portfolio equity outflows. Net external debt, as a percent of GDP, is now almost half its level in 1995, gross external debt has fallen over the same period, and the debt service burden has shrunk significantly. Nevertheless, external debt, at about 60 percent of GDP on a gross basis, remains high, although the public sector share has declined substantially, while private sector debt, mostly that of foreign-owned corporations, has increased from low levels.

2.3. Trade relations

More than ten years after the fall of state socialism, the question is not whether the European integration of the Hungarian economy would start, but whether it would be accomplished. From a microeconomic point of view, the Hungarian economy has been largely integrated already into the structures of the EU-zone. This process was accelerated by the 1991 association agreement between Hungary and the European Community, which was followed by similar agreements between other countries of the region and Brussels.

As a result of the market opening, the share of the EU within the total Hungarian trade increased from 40 per cent to 60 per cent within a few years (see Tables 3 and 4). In 1995, 63 per cent of the total Hungarian exports went to the EU, and 62 per cent of the total Hungarian imports came from there. The role of the EU also increased within the Hungarian foreign trade deficit; half of the trade deficit derived from the EU relation as early as 1995.

The share of the EU did not change in the total Hungarian agricultural exports, but it increased sharply in agricultural imports: from 25 per cent to 44 per cent. Agriculture in general has become less significant than before in the trade between Hungary and the EU: in the early 1990s this sector provided 25 per cent of the Hungarian exports to the EU, and its share fell to 15 per cent by 1995. Due to the destabilization of Hungarian agriculture and the protectionism of the EU, the erosion of the Hungarian agricultural exports to the EU continued in the second half of the 1990s too.

The balance sheet of Hungarian foreign trade within the GDP context was effectively improved by privatization that was carried out simultaneously with the inflow of foreign working capital. Due to the exports of transnational corporations, the share of the EU in the Hungarian exports reached 75 per cent in 2000, while in the imports the EU share remained at about 58 per cent. This meant that the Hungarian trade relations with the EU – contrary to the total Hungarian foreign trade – produced a surplus, at the level of USD 2356.4 million. It needs to be underlined, however, that this was due to the exports of the foreign owned companies, and not to the competitiveness of the Hungarian owned sectors. Furthermore, notwithstanding the remarkable export offensive of the multinational sectors in the second half of the 1990s, the Hungarian GDP only reached the level of 1989 in the year 2000.

Thus one can conclude that the market re-orientation that followed the collapse of state socialism resulted in substantial losses for the Hungarian economy, and the gains produced in the second round did not compensate the Hungarian society. Because of the privatization of the economy, the increasing exports incomes arrived to the owners of the owners of capital and, since foreign owned firms have received substantial tax cuts, these incomes had very little benefits for the government budget.
3. Political issues

3.1. Doubts, criticism and nationalism

Ten years after the association agreements, most experts agree that the trade agreements have largely benefitted the EU, while the burden of adjustment and harmonization fell largely on the Hungarian side. Therefore, it is understandable that Hungarian people are slowly getting tired about the bright promises of the European Union membership, primarily because the date of accession has been postponed several times.

In 1990, when the first post-communist government took office, prime minister József Antall claimed that Hungary would become a member of the European Community by 1996. He did so because of some informal promises made by German Chancellor Helmut Kohl. When his successor, Péter Boross submitted Hungary’s application for EU membership in Spring 1994, he thought 1998 would be the date of entry. Between 1994 and 1998, the government of Gyula Horn considered 2002 the likely date, but this was already handled as a hypothesis after the new premier Viktor Orbán met Jacques Chirac twice in the Summer of 1998. After the Helsinki summit at the end of 1999, the 2002 deadline was abandoned, but it was still widely believed that the first Eastward enlargement would take place before the next elections for the European Parliament, i.e. 2004.

By the late 1990s, it became clear that the failure of a quick accession and the controversies of East-West relations can fuel nationalist political ambitions. Fidesz-MPP that developed itself to be the leading force of the political right in the late 1990s declared that Hungarians should negotiate with the EU as businessmen not as diplomats. In 1998, the far right party MIÉP was the first parliamentary force to oppose EU accession explicitly. Nevertheless, MIÉP remained a right wing opposition for the coalition, and the Orbán-government maintained loyalty to the main framework of the integration policy.

Though the “European dream” of the post-communist societies was seen as an illusion by the more literate researchers from the very beginning of the transition, now even the critics have to say yes to the Eastward enlargement of the EU. The explanation lies with the developments of the 1990s. By opening up the markets to the West and selling much of the “family jewelry” to the Hungarian economy, the EU has practically received all it could from the deal with a less developed partner. This should now be seen as “sunk costs” that should not be ignored until there is hope for some return from the enlargement process for the associated countries. Furthermore, NATO has been enlarged in the meantime, and while Poland, Hungary and the Czech Republic find themselves inside NATO and outside the EU, they can expect a development path more comparable to Turkey rather than Portugal or Ireland. These considerations allow us to believe that the broad camp of Hungarian Europhiles cover a wide range of diverse opinions.

3.2. The progress of negotiations with the EU

The actual accession negotiations between Hungary and the EU began in March 1998, under the British presidency of the Union. The first phase of the negotiations ended in June 2000, which caused satisfaction in the Hungarian foreign policy community. Within the first two years of the negotiations, every chapter, namely 29, was opened, and 11 were closed temporarily. These chapters covered the areas where neither Hungary, nor the EU demanded derogations (small and medium enterprises, research and development, training and education, statistics, industrial policy, communications and information technology, fishing, consumer protection, economic and monetary union, foreign and security policy, and financial control).

By the end of the year 2000, some two thirds of the chapters had been closed temporarily between the EU and Hungary. This was good progress, though some most important chapters were still left behind, like agriculture and environment. These were the very same areas where the years of the right wing government after 1998 not only did not make too much progress but made an effective harm to the level of readiness what concerns the state of these sectors and the government agencies.

The negotiations over the remaining areas required the EU to create at least a hypothetical date for the next enlargement round. This was indeed produced in Nice: January 1, 2003. This was not a guaranteed basis, but it was supposed to be the final date for the closures of the negotiations. The Hungarian government wanted to make progress with the negotiations in order to allow an accession to take place in January 2003.

The developments with the accession talks have not made a significant impact on the generally positive attitude of the Hungarian public to the question of EU enlargement. One of the reasons for this is that very few details reach the electorate out of the content of the negotiations. It also needs mentioning that
a good deal of domestic scandals occupied the public attention in Hungary since the talks began in 1998. However, what has become a matter of domestic political debate is the country report of the EU that comes out every Autumn. The report of 2000 brought attention to problems like government corruption, low environmental standards, lack of social dialogue and the worsening situation of the Roma population of Hungary. Since 1998, the Socialist and Liberal opposition parties have invested a lot in explaining the public how the opinion of the EU has deteriorated after the right wing parties came to office. On the other hand, the government coalition kept on arguing that the EU opinion on Hungary was still much better than on other applicant countries of the region.

3.3. The political climate after Nice
The results of the Nice summit made the Hungarian foreign affairs community optimistic, or even enthusiastic about the perspectives of EU accession. The officials of the right-wing government received all developments of Nice with apparent satisfaction, or at least by saying that we could not hope for better within the prevailing conditions. Viktor Orbán and his foreign minister János Martonyi - together with their parliamentary opposition - overlooked the fact that the influence of small countries was diminished in Nice. They only focused on the fact that the long overdue institutional reforms were now carried out, and there were no further obstacles of such nature to enlargement.

Just a few weeks after the Nice summit, this official enthusiasm was boiled down, when German Chancellor Gerhard Schröder announced that a seven year delay should be applied with the establishment of the free movement of labour after some associated countries have become full members of the EU. Hungarian politicians and commentators tended to pay more attention to the positive outcomes of Nice instead of the negative comments by Schröder, probably because the latter is seen as a matter of German domestic politics that can only indirectly affect the process of enlargement.

In the post-Nice situation, the Hungarian public remains ill-informed about the nature of EU integration while the political elite remains firmly committed to the forthcoming accession. The political parties of Hungary remained pro-EU with no exception. Until 2002, the ruling right wing government of Viktor Orbán disliked the ‘socialistic’ tendencies of the EU, but they also had their main allies within the EU, like Schüssel, Stoiber, Berlusconi and Hague.

The Socialists, who formed a coalition government with the Free Democrats again in 2002, represent the mainstream social democratic position in Europe, which claims that the EU embodies a world class single market and in the same time a social model that is more progressive than the ultraliberal model of the United States. Recently, the Socialist politicians started to voice that the European integration would also serve for us as protection from the negative impacts of globalization. Liberals describe the EU as the arena of fair competition where the free migration of labour will contribute to social and political harmony.

Since the EU entry represent common sense, the prime goal of the Hungarian foreign policy and also a compensation for the pains of the post-communist transition, even parties at the extremes of the political spectrum tend to support and even encourage the process of integration. The far left Workers’ Party only adds that the accession should benefit all citizens, while the far right Party of Hungarian Justice and Life demands restraintson the operations of foreign capital and on the rights of foreigners to buy Hungarian land in exchange for EU membership.

4. The politics of the referendum
At the end of 2002, the Copenhagen summit ruled that May 1, 2004 will be the date of accession for ten countries if both sides agree with the conditions set by the five-year negotiation process. Thus the enlargement will take place early enough to allow the new member states to participate at the European Parliament elections of 2004. The Hungarian establishment feels confident that Hungary will inevitably participate in this enlargement and that the outcome of that will meet their expectations and those of the people.

It is, however, by no means certain that Hungary will remain in the vanguard of EU accession, and it is even less likely that the entire shopping list of integration economics can be delivered by the negotiators. In some areas, the negotiations left behind a sour result, or at least one that can be criticized by the opposition of the day. Agriculture, for example, can very easily turn out to be an area where any possible result can be interpreted as discriminatory, which gives rise to the politics of national grievance. The Hungarian government lacks a comprehensive economic and social strategy that could diminish the negative impact deriving from the increasing deficit on the current account - this is expected to rise after joining the single market - and the intensifying
double exploitation of Hungarian labour (by domestic and foreign capital). The end of 2002 brought a heated political debate about the exchange rate and the expected introduction of the Euro too.

Public opinion in the months before the 2003 April referendum showed a shift towards the no side, though with a yes majority still. The reason for the change is that the right wing opposition tended to voice a lot more criticism of the EU and the accession treaty than before, in order to undermine the position of the government. The latter considers a large majority in favour of accession its own success, and launched a propaganda campaign in order to convince the people about the benefits of accession. Previous experience, however, contributes to the decline of trust in governments on international affairs.

Before Hungary had joined NATO, pro-West politicians proclaimed that NATO and EU were the two sides of the same coin, and we have to join both for a brighter future. NATO expansion took place in 1999 but the expectations of a more peaceful world were not met: two weeks after membership Hungary was in war with her neighbour, Yugoslavia. Some commentators fear a similarly catastrophic outcome of EU enlargement to take place.

‘Little can now be done about NATO membership but the East Europeans’ application to join the EU does still give some room for maneuver and scope for social solidarity. Within the EU itself during the drive towards the completion of the internal market, the “1992” programme, the Left got quite a broad based campaign going to say “no internal market without a social chapter”. That is, an “even playing field” for capital was not in working peoples’ interest. Inadequate as the eventual “social chapter” was, it did nonetheless act as a rallying point for forces from Social Democrats leftwards. With daily news of western firms moving production eastwards, a call for no enlargement without a social chapter would be a good and practical step for pan-European labour movement solidarity. Unless we do this, relocation of production to the east could lead to a xenophobic and truculent reaction in the west.’ (Hindley 2000)

Such concerns were not addressed by the accession talks and it is unlikely that they would come to the agenda before May 2004. However, progressive politics should consider EU enlargement on the agenda as a policy of regional settlement and development, and we have to prepare for the period when the tensions arising from the underdevelopment of the ten new member states will have to be faced. In the long-run, membership in the EU can provide treatment for our economic and social problems, while the chances are much worse for those who remain outside.

References

Part 3:
The emerging model of European capitalism in the global context

What kind of Europe do we want?
    K. Lóránt

Liberal models of European construction
    C. Samary

Trying to catch up: the transformation countries and the treacherous playing fields of the global market
    E. Matzner

What is the American model really about?
    J. Galbraith
The emerging model of European capitalism
What kind of Europe do we want? Hungarian civil society organisations about the future of Europe, values and expectations

Karoly Lóránt

1. Introduction

The Hungarian Civil Society Council, the largest umbrella association of civil society organisations in Hungary, has decided to carry out a poll to collect the opinion of its members as regards the future of Europe. This poll is connected to the work of the Convention and the questionnaire was based on the issues that turned up in the debates during the first three months of the Convention.

The questionnaire contains 15 issues that cover a wide range of problems, from the political shape of the united Europe to the European values, economic policy or the Eastern border of the Union. Because the Hungarians’ knowledge about European affairs is rather poor, each question begins with some explanation, and in some cases – as some of our critics have already reproached us for – it suggests some kind of answer. It is true and we would not say that we are „neutral” or unbiased in several questions since we represent a special group of people. Consequently we do not say that what will follow is the opinion of the Hungarians, rather that it is the opinion of an important group of people in Hungary who may represent people in similar life situations in other countries all over Europe.

Despite these methodological shortcomings, we sincerely believe that our questionnaire addresses the real problems and that getting acquainted with the results will be useful in both sides of Europe, even for those who do not share our values.

2. Question 1: The political form of the Union

The question

The first and most important question is whether Europe’s future should take the form of a federative state like in the German Federative Republic (federation of provinces) or should create a group of independent nation-states where the relationship would be strengthened only when common interests are at stake. At the present, both proposals are before the Convention, the former one has been initiated by German high officials (confederation), the other one gives priority to the alliance of nation-states. During the debates in the Convent, small states have voted for the alliance of nation-states, while representatives of certain larger states argued for the federative construction along with the representatives of the administration in Brussels.

What do you think Hungarians should prefer?

The answer

It turned out the greater part (some 77%) of the members of our civil society organisation prefer the alliance of nation states to the federal form of Europe. As one of those who answered the questionnaire emphasised, in Europe today the cultural and income differences are too big to incorporate all the European nations in one federation (understanding the federal state to be something like Germany). The United States of Europe might be the result of a successful catching up process in which the nations of Europe are getting closer and closer to each other both culturally and economically. So the immediate goal might be only an Associated States of Europe with a closer co-operation of the neighbouring regions, with the United States of Europe being a goal on the horizon. (Figure 1)

3. Question 2: The European values

The question

We have to answer the question, why do we call ourselves European, what distinguishes us from other nations on the Continent. The respect of human rights, social sensitivity, tolerance, solidarity and assurance of equal opportunities are considered common and traditional European values.

One of the delegates representing the Irish Labour Party in the Convent came up with the idea that the social market economy is a value that protects all the...
people in Europe against the detrimental impacts of
globalisation. Globalisation has already caused so
much suffering to the people in the Asian, Latin-
American, African and even developed countries
where the standard of living of significant social
groups has decreased.

What is your opinion? Should we realise a social
market economy or, better to say, an eco-social mar-
tket economy with the inclusion of environmental
protection? Is this a European value to be preserved
in the midst of globalisation to keep us, employers
and employees, together in solidarity and partner-
ship in Europe? What else do we have to keeps us,
Europeans, together?

The answer

The members of the Hungarian Civil Society Coun-
cil put a great emphasis on the social market econo-
my as a basic symbol of European values. They
underlined the importance of defending the Euro-
pean Jewish-Christian cultural heritage, which
values solidarity, social and economic rights, tole-
rance and consensus-building. Environmental pro-
tection would be also an important European value.
They also raised the idea of fighting against the
negative impacts of globalisation as a task that is
close to the European values. (Figure 2)

Fig. 2: The frequency of the different elements mentioned as
European values

<table>
<thead>
<tr>
<th>Element</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social market economy</td>
<td>40%</td>
</tr>
<tr>
<td>European cultural heritage</td>
<td>30%</td>
</tr>
<tr>
<td>Environmental protection</td>
<td>20%</td>
</tr>
<tr>
<td>Tolerance, multiculturalism</td>
<td>15%</td>
</tr>
<tr>
<td>Solidarity, social rights</td>
<td>10%</td>
</tr>
</tbody>
</table>
| Fighting against the negative impacts of
globalisation                              | 5%         |
| Consensus-seeking policy                   | 0%         |

4. Question 3: The price of
European Solidarity

The question

It is easy to affirm solidarity as long as it does not
cost money or at least not our money. Hungarians
like other applicant nations - want to gain signifi-
cant support from the European Union. But the
money does not come from the Union itself, it comes
from its citizens. In the last half century German tax-
payers were mainly the net financier of the Common
Market (the predecessor of the Union).

What do you think, how much advantage have Ger-
man taxpayers gotten from the support of European
integration? How much percentage of your income
would you devote to less developed Southern-Euro-
pean countries (such as Rumania, Bulgaria, Mace-
donia, Kosovo)?

Is there any economic policy favourable both to
developed and undeveloped regions of Europe?
What kind of policy is this supposed to be?

The answer

The respondents emphasised the importance of some
kind of program for the less developed countries to
help them in their development. There is a need – to
some extent – for a redistribution, which would save
Europe from the problems coming from the pauperi-
sation and the slums in the poor regions and, at the
same time, would strengthen the social fabric and the
unity of the European Union. There were opinions
arguing for a gradual enlargement. Their point was
that a less developed country needs another kind of
economic policy than a developed one. To apply the
same economic policy wouldn’t help the less deve-
loped countries in their catching up. Some argued
that it is possible to work out economic programs
that would be advantageous both for the developed
and the less developed part of Europe (remember the
Marshals plan, which helped not only Europe but
America as well). Probably – suggested somebody –
a planning office (EUROPLAN) would help to solve
the problems coming from the accession of countries
with underdeveloped infrastructure and agriculture.
The predecessor of the European Union, the Europe-
an Coal and Steel Community, was also based on
plans to distribute the production between the mem-
ber countries. Others were sceptical about finding
economic policies serving everybody’s interest, or
made the point that the enlargement itself with the
current means will solve the problems.

It is always easier to spend somebody else’s income.
From this point of view it was interesting to learn
from the questionnaire how the Hungarians themsel-
ves (at least those who participated in the poll) are
ready to help the less developed countries improve
their income. It turned out that about two-third of the
respondents do not want to help others, at least not
until their income reaches the average in the Union.
But one-thirds were ready to sacrifice some part of
their income for the purpose of solidarity. Most of
them offered 1-2 percent of their income (Figure 3).

5. Question 4: Which questions should concern the Union and which ones should concern the nation-states?

The question

Hungarians may easily answer this question, since less than a hundred years ago the country still belonged to a multinational Austro-Hungarian Monarchy. It is obvious that foreign affairs can be handled and represented much easier if the Union has one voice. By the way, this has been proposed by all advocates in the Convent who dealt with foreign policy issues. The same stands for military affairs. What is your opinion as to what problems the Union should address and what problems the nation-states should deal with?

The answer

It may have been a relatively simple question because the answers were rather unanimous. There are three main issues, which – according to the civil society organisations – are without doubt under the competence of the Union. These are foreign policy, defence and the constitutionality, which means that the central institutions of the Union must ensure that the basic rights of the people prevail everywhere in the Union. Many think that there is a need for a common economic policy (first of all monetary policy) and that environmental protection is also an issue of responsibility at the central level. Some suggested that the development of transportation infrastructure is a common task, as well as the setting of some common standards in the education. It was also suggested that there should be support for communication between the nations of Europe.

As regards the issues of national policy competence they are first of all the following: education, culture and social provision. But it is natural that almost all issues should be handled both at the national and Union levels (Figure 4).

6. Question 5: Are special forms of co-operation possible within the European Union?

The question

Monetary co-operation exists among 12 member states using the Euro as the common currency, while 3 countries (Great Britain, Denmark, Sweden) did not join the Euro-zone. New member countries also remain outside the Euro-zone for a while. Are special forms of co-operation possible within the European Union? For example, should co-operation among the Visegrád-countries be maintained and developed?

The answer

The opinions on this question were rather divided. Approximately half of the respondents shared the opinion that there is no need for a closer regional co-operation, it was disadvantageous, because it would increase the polarisation between the different regions. Others, on the contrary, were of the opinion that a closer co-operation between neighbouring countries would strengthen the cohesion of the Union and that there are already examples of closer co-operation, for instance between the Benelux countries. Some 40 percent of the answers underlined the significance of the co-operation between the Visegrád countries (Poland, the Czech Republic, the Slovak Republic and Hungary).
7. Question 6: What should the foreign policy of Europe look like?

The question

Do you agree with the argument that cultural diversity of the world is a value to be preserved? Cultures are equal, regardless of the technical development of the given society (Islamic or native cultures are values to be preserved and only their populations can decide about any change). Europe should accept and support cultural diversity and only intervene in any conflict outside Europe if this conflict seriously jeopardises basic human rights. What is your opinion in this regard?

The answer

The respondents accepted the formulae suggested by the questionnaire and emphasised the importance of tolerating cultures that differ from ours. At the same time, Europe should speak out against those who violate people’s basic rights. Europe should intervene in the affairs of countries outside of the Union only in exceptional cases. Contrary to the practice of the United States, Europe in its international relations (especially towards the developing countries) should emphasise the human considerations. But there were sporadic opinions that Europe is a great power and it should behave according to its economic interests; too much idealism might be harmful. And finally, there was somebody who for the question regarding the foreign policy of Europe very honestly answered: „I have not the slightest idea”. (Figure 5)

8. Question 7: What are the boundaries of Europe?

The question

The geographic and political boundaries of Europe do not coincide. The geographic boundary starts from the Ural and crosses the Bosporus. Russia and Ukraine are, therefore, European countries, as is Turkey. At the same time Europe has different zones, from the cultural point of view. There is a dividing line, for example, between Western and Eastern Christianity or between Christianity and Islam. Except Belarus, Ukraine and Russia, all nations are applying for membership in the European Union and all will likely be members within a few years, except Turkey. Where, do you think, the enlarged European Union should have its boundaries in the future?

The answer

In this question the respondents were very divided and there are two strong currents of opinion. One is that the political boundaries of the Union should be the geographical ones. Europe stretches to the Ural mountains and every country that wants to be a member should have that possibility if it accepts the basic values of the Union. The other current states that the eastern border of the Union is somewhere around the east border of Central Europe, i.e. the east border of the Baltic states: Poland Hungary, Romania and Bulgaria. With every enlargement, the Union will lose some part of its convergent power. The big question is really the position of Islamic Turkey. There are opinions that Europe can have nothing to do with an Islamic country; others argue that in the long run, Turkey can also be a member. Even those who set a limit to the geographical expansion of the Union say that there is a need for special co-operation with all countries around the borders. (Figure 6)

9. Question 8: Are we going to have a common language?

The question

Each of the languages of the member countries are officially used in the European Union. That is, there
are 11 languages, because Austrians speak German, Irish people speak English, and Belgium and Luxembourg do not have individual languages. What will happen if the Union will have 27 or even more member states with a dozen new languages in a situation in which translations into many languages already cause a lot of problems?

Esperanto could be an original common language of Europe, but it is spoken only by very few people. English, however, is a very widely spoken language, especially in smaller member states. Is it possible that the official language for communication among EU countries will be English, while every country keeps its own national language. Does it mean that Europeans will be bilingual, speaking both a national language and a language for communication? Or should there be more official languages? What is your opinion?

The answer

In this question the Hungarians (i.e. the respondents) were very unanimous, probably because in Hungary most people – if he or she speaks a foreign language at all – speak English as a second language. So not surprisingly, almost ninety percent of the respondents agreed that Europe should be inherently bilingual, meaning that beside the national language, English should be the second language, the language of communication among the nations of Europe. Only some ten percent of respondents mentioned there should be more common languages (besides English German, French, and Spanish were mentioned). And they had some real fun with Esperanto.

10. Question 9: The common media, “The Voice of Europe”

The question

The media is criticized by many civil society organisations, saying that it is under the rule of a handful of people and does not represent the interests of the whole of society. They suggest that the decisive part of the media should be taken under social control. European values should be transmitted by television and radio, a sort of “Voice of Europe” channel that would inform European people about common causes, as well as informing the world about European affairs. What is your opinion on this question?

The answer

Nearly two-thirds of the respondents stood definitely for a common European media (television broadcasting such as CNN, a radio station like BBC international, or a newspaper like the International Herald Tribune), which would be independent and not-for-profit. Their reasoning frequently was that only a profit-free media would be better able to convene the European values, to deal with the real problems of the people. There were suggestions for regular „national days” in the media, when the people of Europe could get information about the life and problems in another countries. Some argued that the trade unions also need some kind of media to make their voice hear.

Those who were sceptical (one-third of the respondents) mentioned that there is no need for a common media, because the great majority of the people watch or read the national media anyway, or because they were afraid of the negative impact of the common media on the national one, or because they did not really believe that anything can be done against the power and growing concentration of media today.

11. Question 10: Can we leave the European Union any time?

The question

Should the possibility and conditions of withdrawal be defined in advance? Is it important that in case a national referendum decides to leave the European Union, withdrawal be in a regulated form according to predefined rules?

The answer

The majority of the answers advocated a constitutional regulation of withdrawal and looked at that as a normal and possible event. But many think that membership in the Union is final and that there is neither need nor possibility for a withdrawal. Some say that the withdrawal, if it is possible at all, should be an exceptional case and the Union should raise

**Fig. 7:** Can we leave European Union any time? (relative frequency of the answers)

- There should be a constitutional way for withdrawal (50%)
- Not possible, or it is not a question to deal with (20%)
- Withdrawal is possible only in exceptional case (30%)
obstacles against it. (Figure 7)

12. Question 11: The economic policy of the Union

The question

The question addressed four main issues that have great importance in the debates around economic policy in Hungary. These were the role of the state in the economy, the ownership structure (private, state-owned), the role of foreign ownership, especially as regards land property (soil), and, finally, the common budget.

The answer

A great majority of the respondents think that the state should play a significant role in the economic life of a country, especially in the less developed countries like the new applicants. Governments should help the progress of the less developed regions. At the same time, there is a need for tight social control over the activity of the state. It was a minority opinion that government should retreat to the narrowest territory, leaving as much to the market as possible.

As regards the ownership structure, the overwhelming majority of respondents say that basic social services, such as education, health care and pension provision, should basically remain under state (common or social) ownership. The best form of ownership for the basic infrastructural networks (first of all for the railway and motorway network) is also state ownership. Some argue that the privatisation of public works was a success and that it is more efficient to run them as private property.

Foreign ownership is a hot issue in Hungary because – as a consequence of privatisation and foreign direct investments – some 60-70 % of the industry and basic infrastructural provisions (electricity, gas and water supply) are under foreign ownership. The ownership of land is probably the most sensitive question.

According to the poll, some 60 percent of the respondents shared the opinion that in some way the ratio of foreign ownership should be limited. There were some suggestions for a limit of 30-40% in industries. Others suggested following the examples of the Western-European countries. For the remaining 40% of the respondents the ratio of foreign ownership was not a problem, they underlined the role of foreign capital in the development and technological progress.

In the case of land, almost half of the respondents had the opinion that, with some restriction, it might be sold. Almost 30% said that land property should remain under Hungarian ownership and a quarter of the respondents stated that foreign ownership in agriculture is not a problem. (Figure 8)

As regards the common budget, the overwhelming majority of the respondents think that the central redistribution might be somewhat increased and that the surplus should finance the common infrastructure, the development of the poorer regions, and the levelling of the income differences. The suggestion as to what part of the GDP should be centralized varied from 2 to 10 percent. The upper end of the scale belongs to a federalist vision of Europe.

Only one-seventh of the respondents said that it is not necessary to increase the contribution to the common budget, and 30 percent had no opinion. (Figure 9)

13. Question 12: The catching up of the new member states

The question

Is it necessary to introduce special “catching up”
programs (for example technological transfer) to speed up the development of the new members?

The answer
Not surprisingly, the great majority of respondents voted for special development programs for the new (would-be) member countries. What is more interesting were the areas in which they suggested such kind of programs. The main areas were the transportation network, environmental protection, education and reducing the technological gap.

The respondents emphasised that without special programs, the less developed regions will pull back the others. Thus, the desirable coherence of Europe cannot be reached without special programs that accelerate the development of the newcomers.

14.Question 13: The relationship between the Union and the developing world

The question
Many civil society organisations think that the support of developing countries is the moral obligation of Europe. Do you agree with the following statement: “The Union has to support developing countries for the benefit of their own economies (and not for the benefit of the Union). These countries should not be considered as market or cheap labour resources for developed countries. Europe should provide them with efficient technology proper to local conditions”? What do you think about this?

The answer
Similar to the point above, respondents stand for helping the developing world. It was said to help the poor is not only a humanitarian action, the European Union will also benefit from the progress of the developing countries. It is much more important to facilitate their own development (for instance with technological transfer) than giving them aid.

15.Question 14: How much of Europe should be “green”?

The question
Many scientists in the academic community argue that in the long run the wasteful consumption prevalent in developed countries cannot be maintained without destroying nature. How important is it to maintain long term ecological equilibrium, and would you make sacrifices for this even if it causes inconveniences for you (public transportation instead of a car)?

The answer
Every respondent said that environmental protection should be an important common task of the enlarged European union. Many underlined the significance of the mass transit system as a mean to decrease the burden on the environment. Others think that cars can and should be improved from an ecological point of view. One-quarter of the respondents stated that she or he is ready to sacrifice more for environmental purposes.

16.Question 15: How do you feel about Europe?

The questions
Do you feel that you are a citizen not only of your country but also of Europe, and since when have you had this feeling? What do you expect the most from becoming a member of the Union? Is there anything you are the most anxious about in becoming a member of the Union?

One-third of the respondents answered that she or he feels the historical and cultural unity of the Europeans. One-fifth said that to be European is a natural state for them. Others feel themselves European when they are on tourist trip out of the continent. Only one-fifth of the respondents said that she/he has seldom the feeling to be European. A small minority took this question from the practical side saying that to be a European means the use of the common currency, the Euro, or getting some support from the common budget.

In connection with the positive side of membership, around half of the respondents hope that the accession to the European Union will accelerate the economic growth of the new members and that the living standard will definitely increase. One-fifth of the respondents hope that the accession will facilitate the constituency and strengthen the democracy and security. Only one-tenth of the respondents believe that membership will bring greater possibilities for job-seeking in the Union. A similar number relate membership with cultural progress and the strengthening of European identity.

As regards the possible negative impacts of the accession, there are two things about which the respondents are afraid. One is the defencelessness in the face of forces that cannot be controlled by local governments (for instance, overly strong competition, the harsh impact of globalisation, the dictates of Brussels etc.). The second one is the economic fall-
out that might arise from the weak competitiveness of the accessing countries. Some are afraid of loosing their sovereignty and national identity. The room for governments to act will narrow. Too much sacrifice will alienate the country from the Union. Only one-tenth of the respondents said that they have no bad feelings at all. (Figure 10 and Figure 11)

17. Summary

Summarising the results of our poll, we can say that the Hungarians look at the accession with hopes and fears. Hopes that after so many years Hungarians will once again be in the main stream of European development, and fears that uncontrollable forces will cause harm to the Hungarian society and to our sovereignty, and that national identity will be diminished.
Liberal models of European construction

Catherine Samary

1. Introduction

It is a “liberal” (in reality neoconservative) and universal article of faith that privatisation and the unfettered mobility of capital internationally must bring growth and satisfaction of needs at the lowest cost. So the cornerstone of liberal orientations is the free flow of private capital, combined with the “flexibility” of the labor force, both according to market criteria.

The external vectors of this trend in the world, those that provide the needed “experts”, have been the major international financial institutions. But, more important for Central and East European countries (CEECs), it has been the European Union (EU) itself which imposed as criteria for becoming member, the very same “adjustment policies” imposed elsewhere by the IMF, despite the fact that the EU is often seen from outside as an alternative to the liberal globalisation.

The dominant discourse associates the successes of the “transition” in Eastern Europe with these structural transformations measured in figures on privatisation. Theoretically, the more open one country is to privatisation, the more it is supposed to attract foreign investments (the source of efficiency), and the better off it ought to be. So that those recipes play the role of the de facto criteria for Eastward enlargement of the EU.

The balance sheet bears little relationship to this dogma. Which also means increasing contradictions of the liberal construction of Europe – and therefore possible variants along several possible scenarios of more or less open crisis.

In the former “socialist countries”, liberal recipes meant wiping the slate clean, doing away with not only the bureaucracy or its single-party system (which would be met with near-universal joy) but the old system as a whole: the financing of the economy had to be oriented by private interests supposedly always more “rational” and “efficient” than any kind of public financing and management.

Although these precepts and hypotheses are more controversial than ever among Western economists (e.g. Joseph Stiglitz, former vice president of the WB, and new Nobel Laureate), the new/former elites and “experts” in Eastern Europe are much less receptive to criticism of them: they must “prove” that they have broken with the “socialist” past. “Economic science” (liberal doctrine, in fact) supposedly replaces the political arbitrariness of the old single-party regime. And privatisations are often presented as the only way to get rid of the bureaucratism of the past. Any way, they are a preconditions for credits, aids and future membership to the Union.

The dominant discourse and statistical analyses referring to a “transition to the market economy” have to be judged through the prism of an “alignment” with the criteria of the “liberal globalisation” (the so-called Washington consensus) that has been operating since 1980. Any criticism of liberal policies and unprotected openness to foreign capital is quickly denounced as “old-fashioned”. Those who resist, using popular discontent to get elected, are simply called “populist” instead of recognizing the legitimacy of popular discontent and their election is taken as a proof of a non democratic transformation.

The wealth of Western Europe, the positive image derived from its democratic traditions and the memory of past social policy achievements, served as the principal argument in favour of “swallowing the pill” (albeit with increasing reluctance) of the “systemic transition” in those countries in the periphery and the orbit of the European Union. The privatisations of public services and the elimination of social welfare, subsidies and protection from foreign trade have become “rules” and surreptitiously transformed into “acquis communautaire” – that is to say a supposed already stabilised set of “laws” within the Union, that the new candidates had to incorporate. De facto, the acceptance of the “market law” of free competition and opening to foreign capital has even been a key criteria for judging “democracy”.

In other words, the “right of competition”, prevailing over all other rights, has been the basis for attracting private financing and considering the “advance” of the “transition” towards market and democracy – i.e. “European” model.

2. General forms and logics of capital flows

“Foreign investments”, in the IMF’s standardized balance of payments terminology, refers not to an increase in (physical) productive capacity but to any entry of capital irrespective of its purpose. It may take three major forms:

1. Foreign Direct Investment (FDI): this presuppo-
The emerging model of European capitalism

FDI is “defined” according to the capacity to “control” ownership. An entire business is directly purchased or created, or at least 10% of the shares in an existing company are held by foreign investors. This 10% figure is obviously arbitrary: it does not produce any certainty of stable “ownership” conduct, still less the efficiency of that conduct apart from the simple logic of maximizing the profits of shareholders, especially foreigners. But it reflects a strong trend in contemporary capitalism, exemplified by pension funds: the desire to draw a large number of “small shareholders” ("households") into the financial markets, dispersing ownership while depriving these shareholders of any real power, the effective control over decisions resting in the hands of a “strategic investor” holding a minority of the shares.

This is precisely the dominant form of the privatisations in Eastern Europe: millions of powerless shareholders (through “mass privatisation” de facto without capital) allowing a concentration of assets in hands that are often almost invisible - the State, with its periodic alterations in dominant parties and its turf wars, alternately combining with and confronting the oligarchs and former managers of enterprises, banks and government ministries and of course foreign capital.

2. “Portfolio” investment: this is the bulk of the more volatile and speculative capital - debt securities (bonds), or shares in the capital of a business, provided, as noted above, that they comprise less than 10% of the shares. This “floating” capital is attracted in particular by the privatisations at fire-sale prices under a debt repayment program, or by the high interest rates on public debt issues. One of the IMF’s basic precepts, apart from budget austerity, was to push for financing government deficits through the issue of securities available to non-residents. The Maastricht criteria gave a radical monetarist interpretation and implementation of such trend: not only are member state’s fiscal resources on capital to be reduced by the competition to attract capital, but credits at low rates from the central banks to the state are simply forbidden. Short term public bonds (treasury bills) have been created and open for selling to non resident (those who are precisely the less interested in stable financing of public needs...).

The giddy rise in interest rates on Russian GKO’s (treasury bills) after the Asian crisis, to try to retain in Russia the capital that was financing the debt, was a catalyst of the Russian crisis of the summer of 1998. The sudden swings in such unstable financing were a common feature of the financial crises of the 1990s, from Mexico to Asia to Russia. Some investments in shares can be just as unstable thanks to the development of the “secondary markets” in which these securities can be “liquidated”.

3. Finally, the “other foreign investments” may be credits. They are often hinged on the preceding forms of investment, although the debtor countries prefer FDI because it does not increase their debt burden. But the banks made credits for the purchase of some securities freely available in the period when stock markets were booming. In the Russian crisis, the new private banks themselves promoted speculation in GKO’s in lieu of financing the economy. Who controls the banks controls the underlying logic of the economy. That is why opening up this sector to foreign capital was consistently considered “strategic” and thus protected. The logic of the WTO’s negotiations over “services” was to drop those protections as well.

In practice, the scenario in Eastern Europe involved a limited opening to FDI in the 1970s, but indebtedness for the purpose of importing Western technology, in the hope of later repaying the debt through improved exports. Profits from the oil industry were generally recycled by the private banks to the countries of the South and the East, which became heavily indebted. But the downturn in the advanced capitalist countries and the neo-conservative offensive of the 1980s shuffled the cards – and triggered IMF intervention.

The debt and EU accession then became essential levers for imposing privatisations and an opening to FDI, which was supposed to reduce the debt and, in the countries of the so-called Soviet bloc, to dismantle the old system. According to the neo-conservative dogma, foreign direct investment would be completely beneficial to the host countries. The actual effect requires a concrete analysis: when FDI comes, what is its logics? And what if they don’t come?

The host countries generally expect that non-debt financing will bring in advanced technology and know-how, create jobs and increase export capacity, which can then more than cover external deficits. But the investors’ expectations may be quite different: equity participation in an existing company aimed at controlling a competitor; low-paying jobs with little or no union protection, hence fragile; an
opportunity to unload polluting technologies that are outmoded or prohibited elsewhere; a forced expansion of imports of their own products (notwithstanding existing substitutes), etc. Far from a sharing of technological and scientific knowledge, the general dynamic is to exclude the host country, creating an ongoing dependency accompanied by an accelerating and dramatic “brain drain”. The use of parts factories, relocated far from the parent company, prevents the host country from controlling the production process as a whole.

But more important, even, are the limits (quantity, instability, branch and region distribution) of FDI – which raises the question of dependency upon such kind of financing for development and satisfaction of basic needs and infrastructures.

There is every reason to question the logic of the MAI (Multilateral Agreement on Investment) and WTO negotiations, in which a central issue is precisely a state’s right to control investment, and hence to be able to determine its own development priorities and objectives and to subordinate FDI to them.

3. What capital could buy privatised firms in CEECs?

Hungary is the only case (other than Estonia, on a lesser scale) in which the principal form of privatisation from the beginning of the 1990s was the direct sale of the best firms. But in a context in which the accumulation of national capital is very low, it is foreign capital that took the lion’s share (and that is why, until the mid-1990s, Hungary received half of all FDI going into Eastern Europe). However, selling off the best companies to foreign capital was not popular either in the nomenklatura or in the population as a whole. The principal form of privatisation in the early 1990s in the Czech Republic, Slovenia, Russia and Poland was what was referred to (in a number of variants) as “mass privatisation” of public companies: the distribution to citizens or employees of “coupons” (a official paper representing a given amount of money) with which they could purchase shares in the enterprises, now transformed into limited liability companies.

The workers took over these companies in an attempt to stabilize their jobs, opting for “privatisations” that left the majority of the shares in enterprise collectives (including managers). The governments, however, viewed these processes as a means of compensating for the lack of national capital; giving some popular “legitimacy” to the privatisation of the bulk of the firms; “demonstrating” to the interna-

nal institutions that the reforms “were going ahead” and therefore making some headway in their negotiations over their debts and membership in the EU; and enabling the former managers of the firms and the party/State to allocate to themselves substantial shares in these “privatisations” and open up a process of undermining social protection measures.

But none of this brought new money into the State treasury, nor did it bring about a relationship of forces that would make it possible to impose on the workers restructuring projects entailing high unemployment - although it did make way for some opaque financial transactions.

The privatisations and opening to foreign capital have been characterized systematically - from Albania to Russia, Romania and the Czech Republic - by recurring corruption scandals, rigged financial deals and privatisations of state functions. Veritable wars have broken out over natural resources and tourist resorts (sources of foreign exchange): who will control the oil and natural gas of the former Soviet republics, the mines of Kosovo, access to the Adriatic coast? Far from putting an end to the rule of the old nomenklatura, the privatisations have enabled a great many of its cadres to convert their old privileges of position into privileges of property. “Nationalism” has replaced the rights of the workers in Yugoslavia, legitimizing the new powers - and the appropriation of the territories on pseudo-ethnic foundations. And far from being a “postcommunist” immature feature of “emergent markets”, corruptions and financial scandals within the most sophisticated developed markets like the US, are the “rationale” of short-term and financial profit-making in the context of financial globalisation.

Under international pressure, the second half of the 1990s witnessed an acceleration of the opening to foreign capital in Eastern Europe. But where did it go?

4. Distribution of FDI over the decade

Where it went depended, on the one hand, on the choices made by the ruling groups and, on the other, on the decisions of the foreign investors.

The share of FDI in Hungary has already been stressed as a result of an orientation taken by the former regime to pay back the foreign debt through the selling of the best factories. The relative weakness of privatisations and of FDI in Slovenia up to the end of the 90s is an illustration of the impact of another kind of decisions (under social pressures). Domestic
The emerging model of European capitalism

resistance to “outside advisors” was particularly effective in Slovenia thanks to the fact that the republic’s standard of living and capacity to export to Western European markets were relatively high in the former Yugoslavia. So Slovenia’s past accomplishments and resistance to neo-conservative perceptions (and not privatisations) were major factors in its success and the fact that among all candidates to EU it has the highest living standards (close to Southern Europe).

As far as foreign capital’s choice is concerned, the distribution of FDI in Eastern Europe was dictated by some universal criteria. Private money, in its quest for purchasing power, goes first to the wealthy regions. The bulk of global FDI is conducted between developed countries - in 1998, the source of 90% of FDI and the recipients of 60% of FDI (see UN reports, UNCTAD 2000). In the “rest of the world”, FDI is strongly focused on a few countries in the South and the East, the best off in terms of resources and growth, and especially those where the government is the most firmly established and property rights are protected. The former Soviet Union and the countries of Eastern Europe potentially offered substantial natural resources and/or a cheap and skilled labour force, as well as market segments (wherever there is some purchasing power, although the widening poverty reduces its scope) and, quite simply, quick profits (speculation on “emerging markets”). But political and social instability, the lack of infrastructures (including telecommunications) and thus the high cost of the necessary restructuring, as well as the bureaucratic mazes and jurisdictional conflicts (if not local wars) served as disincentives.

The major part of FDI outside the developed countries went to China, with its strong state. China took in a total of $300 billion during the 1990s, against a mere $15 billion for Yeltsin’s chaotic Russia. The latter, notwithstanding the attractiveness of its natural resources, had accumulated FDI of only $345 per capita by 1997, on the eve of the summer 1998 crisis. Over the same period Hungary, by way of comparison, had attracted more than $1,600 in FDI per capita.

As a percentage of GDP, the statistics sometimes vary considerably, depending on the source. In the Commonwealth of Independent States (CIS), GDP evaluations are often quite problematic owing to the new monetary criteria and the extent of barter relationships. Furthermore, the effective FDI figures may also vary depending on whether contracts are accounted for at the time they are registered as a project or when they are actually completed. According to Wladimir Andreff, Azerbaijan held the record, with foreign direct investment accounting for 70% of its GDP in 1998 (a reflection of the “contracts of the century” in the oil and natural gas industry signed in 1994 and 1998 with the United States and Turkey, but also with Japan, Russia, Great Britain and Saudi Arabia). Apart from this case (and based on the same sources), FDI as a percentage of GDP ranges between 12 and 45 percent in Kazakhstan, Armenia and the Central European countries (the lowest levels being in Slovenia). The other countries of the CIS and the Balkans received less than 10% of their GDP in FDI during the same period. And no matter which source is consulted, Russia was at the bottom of the scale with FDI accounting for less than 3% of its GDP in 1998.

This distribution of FDI in 1998 reflects the larger reality when the FDI figures are viewed from the perspective of the stock of FDI in all the countries in transition in this region. Central Europe (Hungary, Poland, the Czech Republic, Slovakia and Slovenia) accounted for 58% of all FDI inputs. More generally, the ten countries of Central and Eastern Europe that are candidates for membership in the European Union account for 69% of all FDI in the region. In contrast, the CIS as a whole, including Russia, has attracted only 29%, and the Balkans 2%.

Finally, looking at FDI per capita - a more meaningful measure than the absolute figures, and less problematic in interpretation than GDP - it is Central Europe, in the orbit of the EU and the wealthiest part of the group, which was clearly on top in 1998, with more than $1,000 in FDI per capita. Azerbaijan and Kazakhstan came next with about $400 per capita and the vast majority of all the others had between 30 and 100 Dollars per capita (only $91 in the case of Russia).

Luckily for Central European countries, their financial markets are relatively underdeveloped and they were not affected too much by the fluctuations in the “emerging markets” (Asia, Russia, Latin America) in 1998. Their insertion in the EU orbit tended to serve as a positive factor in the eyes of investors. However, there are major differences developing among them.

Together, the CEECs had taken in a total of about $100 billion over ten years by the year 2000 - almost ten times more than Russia. Close to 80% of this FDI was concentrated in the three wealthiest countries of the 10-member CEEC: Poland, the Czech Republic and Hungary. Poland, by its size, had the largest share. In 2000, the CEECs took in about 1.7% of
FDI flows, amounting to about $20 billion in an area with a hundred million inhabitants - half the flow into China that year."

Within each country (Russia as well as the CEECs) most FDI has gone to the capital cities; in 1977, 77% of FDI going to Russia was concentrated in Moscow. As a rule, FDI heads for the most prosperous regions and especially urban concentrations (those with the best infrastructure, the highest standard of living and the most skills). This deepens the inequality between countries and between regions.

The vast majority of FDI is in major retailing (particularly the food industry), telecommunications including mobile phones (France Télécom purchased the Polish exchange TPSA for $3 billion in 2000), and, beginning in the late 1990s, the financial sector: more than 70% of the Polish banks and most of the Central European banks overall are now controlled by foreign capital. This process, which is relatively recent, means that the credit constraints weighing on the major companies may well harden, without giving them real means for restructuring. In Latin America foreign banks are often financing mainly foreign factories – and certainly not “unprofitable” public services. This could be also the trend in Eastern Europe.

Behind the “successes”, as registered in the numbers and quantities of FDI or privatisations, social relations are being transformed. Bulgaria’s real unemployment rate is higher than 30%. Similar levels exist in a number of regions of Poland and Hungary. And far from having reached the “end of the tunnel”, the “most advanced” economies such as Poland, entered a recession in recent months, as did the Czech Republic in 1998.

The deepening of social and regional disparities, the unemployment and foreign trade external deficits illustrate how these countries are experiencing “competition”.

Most of the foreign-owned firms are also the ones that export to EU markets, and they often import their own products. All of the CEECs that are candidates for EU membership are running current account deficits with the Union. The radical restructuring of trade flows in the wake of the 1991 dissolution of the COMECON (the Soviet bloc’s counterpart to the Common Market) has resulted in a new dependency that can be a serious drag on the East European economies. The slowdown in EU growth, particularly in Germany, will mean a significant drop in exports to the West. And domestic purchasing power is limited; the queues have disappeared but most citizens cannot afford to buy the products. Fiscal austerity and the contraction in banking credit will not help to sustain growth. Furthermore, in a country like Poland the desire to attract foreign capital in order to finance the public debt has been expressed in a rise in interest rates that is now adding to the difficulties faced by private businesses.

5. Conditional “assistance” and geo-strategic criteria

The funding originating from the European Union for “assisting membership” has much the effect of a vicious circle: far from compensating for these problems, it aggravates them. For the most part, this funding is not donations but credits (in the case of two thirds of such “assistance”), and conditional credits at that. The criteria for allocation, or for the rescheduling of debts, are in fact political and economic. The interrelationship between “assistance”, credits, privatisations and FDI is therefore “organic”, and associated with the overall economic and geostrategic logic of the governing institutions (governments, international financial institutions and the EU).

In terms of donations, Poland is the only one of these countries to have had her debt cancelled, in the early 1990s - something that is never mentioned as having anything to do with the fact that it is also the first economy to register growth again. The cancellation of Poland’s debt was one of the “other foreign investments” noted in the balance of payments. Concealed in this entry were some geo-strategic considerations: Poland was the only such country in which a mass trade union movement, Solidarnosc, had challenged the old regime, in 1980. The privatisations, allegedly associated with democracy and pluralism, were never demanded by a congress of Solidarnosc. The corruption of the Polish trade unionists - like that of the independent union of the Ukrainian miners in the early 1990s - was also part of the “invisibles” in the balance of payments. That is one more proof that liberal policies (including criteria for “aid”) are far from political neutrality and “pure” economical criteria.

Geo-strategic criteria and world relationship of powers were behind Marshall Plan. Keynesian policies were also an effect of the Cold War. And there was much state intervention and even planning in the post-war reconstruction using Marshall aid. For some exceptional decades in capitalist history, the trend was a reduction of inequalities, an increase of wages in the share of increasing productivity and the development of social intervention of the state.
The conservative offensive behind the language of the Washington consensus of the 80s was to destroy this trend to establish a better position for capital in the share of added value both against labour and against welfare state. The liberal choice of the French left government in 1983 closed the limited resistance 1981-82 to the new liberal priorities. It opened a decade where wages lost ten points in the added value in France. The argument was that at the national level, resistance to liberal policies was impossible. But the “Unique Act” proposed en 1985 by the French socialist government was to orientate the European construction towards… a large market open to free flow of capital. In 1992, Maastricht criteria had to be “monetarist” to convince the German powers to leave the DM. So all new European treaties and institutions of the past 20 years have helped imposing “from above” a “real existing” liberal construction at all national levels. The fall of the Berlin wall and of Soviet Union could only strengthen that liberal and monetarist trend of the EU. German powers hoped that privatisation would pay the price of restructuring East German firms while the monetary union was supposed to consolidate politically and socially the unification without increasing fiscal expenditures. The cost of the unification was underestimated and financed by liberal recipes again: increasing the rate of interest to finance the public debt through foreign capital flow. During a decade the federal government had to transfer about 600 billion Euro to the Eastern Länder – from 40 to nearly 80% of the GDP of those Länder each year. But German unification is politically much different from EU enlargement (see Steinitz in this Reader).

The future boundaries of the European Union are a basic issue. For workers and citizen in general, the reduction of boundaries is attractive. For capital investment on a liberal logic, it is not a problem. Free movement is increasingly imposed. And the lack of financing in the East (or South) is not a lack of mobility for private funds. It expresses the logics of private interest and the lack of public (international) funds for development. But for Western powers and bourgeoisie, the question of boundaries covers other dimensions. The liberal European construction is minimizing fiscal policy on capital. So the concern is also to “minimize the costs of enlargement” and, increasingly, to use the “clandestine immigrant” as the new potential danger: boundaries are both limits for allocations (budgets) and for immigration.

Therefore the presentation of “enlargement’s costs” is highly biased. First because no evaluation is made from the point of view of Eastern European countries and populations: they have no other possible future then to “become European” (a current formula aiming as if they were not, or as if the only European values come from the Western side). It also means that they have no past (except before the communist “parenthesis”), nothing to lose and no other policy to implement then the liberal one. Second because only visible costs through budgets are evaluated – but not invisible gain through trade, for instance; and not middle and long-term cost of social regressions in CEECs. Worse, using cheap and often very qualified labour force from CEECs is both a source of hidden or open profit and an ideological tool for the repressive logics of “liberal” policies.

Over ten years (from 1990 to 1999), the Commission in Brussels has committed a total of 10.89 billion Euros of “aid” (under the dominant form of conditional credits) in favour of the CEECs the richest and closest countries and the net cost of enlargement for 10 candidates (8 from Eastern Europe, without Rumania and Bulgaria plus Cyprus and Malta) between 2004-2006 will be about 25 billion Euro - to be compared with about 600 billion Euro that Germany’s eastern Länder have received from that country’s federal government, and to 97 billion Euro of (updated) Marshall Plan (1948-1951)… During the last decade the EU surplus from trade with CEECs has been $112 billion…

What this means is that, on the one hand, the EU is not prepared to pay, in order to absorb all the CEECs, what it does cost to unify Germany and on the other hand, that the CEECs bring in far more than they cost.

6. Alternative liberal scenarios

But all those policies ad choices are confronted with main contradictions. The budget limit has been fixed at 1.27% of the Union’s GDP in the “Agenda 2000”. One logic has been to propose to reduce the funds allocated to the Southern European countries in order to give more to the East. But strong protests from Spain and other countries receiving shares of European structural funds limit such ideas. Rules have recently also been established preventing new members to have a free move of their workers during at least 7 years after accession, and not to give the same amount to new members.

So, the first (and up to now dominant) scenario of liberal enlargement of the EU has been imposing all liberal recipes as “European rules” decided in treaties and European institutions without guarantees
about the access of new members to existing structural funds, and to labour market: private investment (free capital flow) much more then public financing and European budget, is supposed to pay for that “historical move” without real equality in citizenship (right to work and to receive allocations) between new and existing members. Polish peasants will not receive the same direct allocation then the French: in general peasants in the new member countries will receive 25% of the amount given to their colleague in existing members. And as far as other structural funds are concerned the 10 new candidates will receive each year 114 million Euro for infrastructures while Greece, Ireland, Portugal and Spain will receive 231 million Euros for similar expanses (despite the fact that they are relatively richer than all new members from CEECs. A “rule” has been established: not to give more then 4% of the GDP of a recipient country (to be compared with the amount of aid representing 40 to 80% of East German GDP that those Länder have received…). So the poorer the country, the less it will cost!

That “line” of integration of new members with non equal formal rights could lead to a crisis and a second liberal variant: the transformation of the Union into a simple free Euromarket zone with the suppression of any European budget and logics of “cohesive funds”. But that would increase inequalities and economic pressure for migration from poorer parts to the richer ones. It is often presented as the only liberal scenario – as if the current Union was not another kind of extension of market rules with the help of strong institutions.

But the recent electoral trends show another possible variant. More and more rightwing currents and governments, confronted to increasing unemployment and social unrest, instead of putting in question liberal policy, present “immigration” as the cause of unemployment for “their” workers in the richest parts of Europe. Yesterday delocalisation in the Third world was supposed to be the cause of social desintegration in the North. Today, building new repressive (Schengen) walls against Eastward enlargement could become a dominant liberal concept combining “free trade” and investment in the East while protecting the rich “fortress Europe” from new citizens – workers.

There is furthermore a possible forth variant as a result of increasing consistent “nationalist liberal” answers: “immigrants” would even be from other members states. And an open crisis and split of the union into national states and a crisis of the Euro could occur, along Lepen’s type of policies.

Sure, the promises of enlargement have become a political and ideological challenge as much as the European construction itself: both have been a substitute to concrete debates on social rights and choices of society. The Euro in itself could be used for a different kind of policy. But since the 80s up to now, the dominant socio-political choices have been taken under the pressure of financial markets, not under that of any cold war between systems nor global labour resistance. Social unrests have been constrained by the difficulty to resist collectively at the level where key decisions are taken: multinationals, international institutions, European level. Structural unemployment pushes people to try and find survival strategies – cultivation of small plots or several partial jobs. That doesn’t leave much energy to resist (even to go and vote at elections). And for those who still have jobs, the drop in unionisation (the bureaucratic reality of former trade unions in Eastern Europe), the integration of unions in liberal policies and the new flexibility of labour, all that mean atomisation of resistances. Not to speak of ideological crisis linked with an assimilation of a socialist perspective to the past single party system and command economy.

But false alternatives are more and more rejected. Choices are still possible and a matter of political will and relationship of forces. Liberal policies are more and more confronted to a disastrous universal balance-sheet. The new emerging “alter-globalist” movements with the perspective of a European social forum developing alternatives to the liberal construction of Europe are only the first steps of a new phase: the globalisation of resistances for another world.

---

3 A country’s stock of FDI is the sum total of all the FDI it has received up to a particular date. FDI “flows” are the variations between two dates (usually measured in years).
4 See http://europa.eu.int/comm/enlargement/index.htm
1. Introduction

The problems, which we are discussing today are inherently related to the obvious fact that the relation between countries and regions are to a high extent marked by great asymmetries. This holds generally true for the relation between the USA, the only remaining Superpower and the rest of the world, which make up what I called the monopolar world order. But it is also highly prevalent in the relation we are interested, the EU and its member countries and the candidate countries, between those, which apply for entrance and those which decide about it. The problem is complicated by the global asymmetries which interact strategically and tactically with the European ones.

Before I start my analysis I should like to make my value premises explicit:

1. I am in favor of reducing asymmetries, which are not functionally justified.
2. I am in favor of a multipolar and multilaterally bargained world.

In discussing the problems I shall try to avoid my own particular bias in looking at the problems and in my arguments.

I shall discuss briefly the following five issues:

1. The candidate countries’ structural deficit of the current accounts with the outside world.
2. The must to increase their market shares.
3. The issue of foreign direct investment (FDI)
5. EU’s governance weakness and the vision of a reduction of both asymmetries

2. The candidate countries’ structural deficit of the current accounts with the outside world

A common feature of transformation countries (except Russia) and also of candidate countries is their structural deficit in their current accounts. This follows logically from deregulating international trade in goods, services and capital between less developed and more developed countries.

In Figure 1, the L1L1* describes the decline of productivity/income from “West to East”, or from market based to former centrally planned economies. Area ABCD is the region which is delineated for transborder co-operation. P1 is the “rich”, P1* the poor town. The slightly declining line L2L2* is the target of activities: a great increase in the level of productivity/income in the “Eastern” region, a modest increase in the “Western” one. The aim is to convert the towns P1 and P1*, separated by a border and an “income-fall” into P2 and P2* with a similar level of productivity and income. The intention not to transfer the “income-fall” eastward is equally important, i.e. to assure that town M1, located outside the transborder region ABCD, should parallelly increase its level of productivity/income, from L1L1* to L2L2*.

A reduction of the productivity and income gap and a gradual levelling out of the income slope is in any case a difficult task. It requires a profound change of the socioeconomic contexts prevailing in the two regions. It would require a change of the four basic elements which constitute a socioeconomic context:

The less developed countries have a high demand of both consumer and investment goods. They are by definition less capable to sell their industrial products and services in the rich countries. The result is the permanently recurrent deficit in the balance of payments. Neglecting transfers, the deficit can be
financed by three ways:
a. borrowing;
b. sale of assets; and
c. foreign direct investment.

Borrowing occurs more or less under market conditions. These are in their turn influenced by the rating agencies licensed by the US Securities and Exchange Commission (SEC). The rate of interest charged depends in its turn i.a. upon the size of the debt as share of GDP, the inflation rate, the export revenue etc. Borrowing is strongly constrained except for countries with strategic interest for the USA (NATO), like Turkey. Therefore the deficit countries are urged to pursue policies to reduce the current account deficit by high interest rates, cutting public expenditures etc. are frequent. This, of course, is not the way to enhance the growth of productivity and catching up with the more economically advanced countries. It is an impediment to the reduction of asymmetries. The same holds true for the sale of assets like land and funds of natural resources.

3. Increasing shares in export markets as a precondition of catching up

A precondition for catching up – which is just another way of speaking about reducing asymmetry – is higher growth in investment as well as in production and income. This would require either an export surplus, generous – below market conditions – loans or a high export surplus. In any of those cases the deficit countries’ share in hard currency countries markets has to be increased. This is a must and there is no way to bypass it. This “must” however is rarely made explicit. The official belief of the EU as other international organizations and institutions holds that profit guided private firms will do it spontaneously as soon as free market conditions are established. As the example of the former German Democratic Republic clearly shows, this is not the case. It would not have to be the case, if unification had taken place under a more realistic exchange of East Mark into Western DM. East Germany still is dependent on annual transfers of more than 80 billion Euro or 160 billion former DM. Zero transfers, as demanded frequently by impatient political circles in the rich South, North and West of unified Germany presuppose an increase of East German exports of the same order of magnitude.

Where and how to get the greater market shares? That is here the question.

4. Foreign Direct Investment (FDI)

The answer to this question leads directly to foreign direct investment. They are by many people regarded as a panacea, in particular by those in the World Bank, investment banks and domestic politicians. In reality, foreign direct investment is a double-edged sword. Let us discuss both the positive and the negative aspect connected with this instrument.

FDI comprise both takeover of existing companies and the establishment of completely new production and distribution units in the candidate deficit country. It is obvious that in most cases, whether old or new, the firm taken over becomes a subsidiary of an international or transnational company. This increases certainly foreign influence in the receiving country. There are however overriding advantages connected with such an FDI: Firstly, they bring internationally competitive technology, know-how and organizational methods to the country. Secondly, they connect the in- and outputs of the overtaken firm with the new owner’s network of supply and of distribution. In many sectors products can only be sold under a brand name. Thirdly, FDI bring foreign capital, needed to reduce the deficit in the current account.

FDIs however are not to be had without some negative aspects. The increase of foreign influence was already mentioned. In concrete terms, their focus is often on the control of market shares and less on increasing domestic production. Secondly, they induce a substantial stream of imports complementary to its output. Thirdly, they operate under the rule of targeted share holder value which implies repatriation of profits. Fourthly, with the aid of instrument of derivate financing, FDIs even in production facilities allow easy monetarisation and subsequent withdrawal from productive assets. FDIs are an inevitable, yet less promising way as many still believe.

My tentative conclusion therefore is that the market forces alone will not suffice to reduce the asymmetries in economic and social development and that the asymmetries in economic and social terms would require, even under conditions of membership concrete policies promoting development in both the candidate countries and the EU. This would amount to a major change of policies both at the European and the global level. Unfortunately the times appear not yet to be mature for that.
5. The Washington Consensus and the EU Stability Pact

The Washington Consensus may be called the functional equivalent to the 10 Commandment in the Age. The three most important commandments for (deficit) countries and their policy makers are:

1. Thou shalt believe only in the one and deregulated market and its only equilibrating theory
2. Thou shalt not own non-private production asset.
3. Thou shalt not run a deficit in the public and foreign accounts.

All good people follow the New Lord’s word. Sinners are severely punished by not getting loans, FDIs or new technology as well as MFN status under WTO. The pious you can find in particular among the cardinal bishops and clerical officers in Brussels, in the Commission and the Councils as well as in the provincial capitals. As you can observe, in particular in his new budget, the Pope in Washington D.C. (i.e. domini capital) is exempted from the Lord’s Commandments.

6. EU’s governance weakness and the vision of a reduction of both asymmetries

A reduction of asymmetries between candidates and members, as exemplified in the structural deficit as well as the increase would require:

Step 1: to define the achievement of more symmetry as the overriding target of the EU.

Step 2: It would have to be followed by forceful political action in terms of expansion of infrastructure and of investment enhancing credit schemes, monetary and fiscal policies.

Step 3: It would require instead of the present deflationary policies as postulated by the Stabilization Pact as well as by the statute of the European Central Bank System, an expansionary scheme of monetary and fiscal policies by member as well as candidate countries. An overall expansionary climate would be to the benefit to groups as well as third countries and regions.

For the time being, the EU is not in a position to define a European public purpose. It would violate its own legislation as well as the Washington Consensus. The program outlined, however, amounts to a Post-Washington Consensus, as pleaded for since long by Joseph E. Stiglitz, Nobel Prize Awardee 2001, former Vice President of World Bank and still former Chairman of the US-President’s Council of Economic Advisers. It would allow broader aims and more instruments as the present one. It requires a reduction of the present political asymmetry between the USA and the EU. This is only possible by the EU formulating a political vision of its own. It would have to be different from its present vision and different from that of the USA.

Such a policy would follow a vision of a more bargained multipolar world order. I assume that important voices in our host country would be with it.

Post scriptum (Fall 2002): The Hegemons’ Interest

In summer 2002 there are rumeurs around saying that Eastern enlargement of EU is not in the American interest. According to this line of thought, NATO enlargement is regarded as “sufficient”.

I doubt whether this argument is valid, or even plausible. My judgment rests on the prevalent geopolitical US doctrin. It was confirmed by the recent Quadrennial Defense Review (Office of Defense, Washington D.C. 2001), which repeats the strategic top priority given to Eurasia. In this calculus Europe is not more than a bridgehead. To be taken more seriously, the EU would have to be able to aggregate its political, military and economic resources to an independent European center of influence. This is not even strived for. Eastern enlargement will, under the present conditions, make such a development for quite some time even less likely than today.

Literature


The American Model fascinates Europeans. For many on the right and certainly for the propaganda branches of the official economic institutions (such as the OECD and the European Commission), the free market as they imagine it is practiced in the United States represents an ideal type. It is the highest form of capitalism. It is to be celebrated for its efficiency, for its technological dynamism, and even for its capacity to deliver full employment - all free from the dead hand of governmental regulation and control.

These charms are largely lost on the European public. Certainly they are lost on those who form the intellectual left. In their view, the American model is repellent. Indeed many perceive a fundamental clash between Americanism and such "traditional European values" as fairness, solidarity and tolerance. This view emphasizes the rapacity of the American multinational corporation, the absence of universal social services in the United States, and the poverty and inequality delivered by American labor markets. It is a position taken by many who seek to defend European social democracy from further degradation.

And in the third place there is the position of an emerging group of European progressives. This group regards the arrival of the American Way as a fact of Nature, against which resistance is futile. They are therefore attracted to American solutions to the problems of the American Way. In particular they emphasize the importance of investments in education, of job training, and of new institutions for "life-long learning." Such measures are intended, in particular, to help workers adjust to the inevitable disruptiveness of life under unfettered capitalism. Such was the theme, for instance, of the Portuguese Presidency of the European Union a few years back.

All three groups are concerned mainly with the evolution of economic and social conditions in Europe. None of them are deeply involved in the study of the United States for its own sake. And in this way, the American Model has become a stylized battleground for Europeans, a terrain for struggle between those who would destroy European social democracy, those who would defend it, and those who would adapt it as best they can.

What the three groups share is a stabilized understanding of what the American model is. It is an understanding advanced by many forces emanating within the United States, and characterized by the principal tenets of the "Washington Consensus" - that development strategy articulated by the World Bank and the IMF for the whole world. These principles include deregulation, privatization, and the free setting of prices and especially wages in competitive markets, without interference from unions or concern for the shape of the resulting distribution. They favor free international trade. They favor the reduction of public subsidies, public transfer payments including pensions, and public enterprise to the minimum. And they favor the application of "sound" fiscal and monetary policies, with the former dedicated to budget balance and the latter exclusively to price stability.

As inspection of this list makes apparent, such an image is comparatively recent. It is a vision of America based entirely on the image of America propagated since the early 1980s by right-wing political spokesman and certain academics. Such was the image forcefully, even eloquently, articulated at the time by President Ronald Reagan, and captured by his phrase "the magic of the marketplace." It is a tribute to the enduring power of Reagan's rhetoric that such an image of the United States continues to serve as a template for political and economic arguments in Europe twenty years later on.

But it is also an image with little foundation in the American reality. It is useless as a guide to American economic performance. It is a vision rooted neither in the historical nor the modern facts of American life. It is, in short, a fantasy.

It is a dangerous fantasy for European progressives. By accepting it, they find themselves acknowledging the existence of an economy led to full employment, at least for a time, through the application of free market principles, including radical deregulation and the destruction of unions. They therefore find themselves in the position of defending the dismal economic performance of modern Europe, and specifically high unemployment, on the ground that the alternative has unacceptable social costs. In this way, acquiescence in mass unemployment becomes the price of defending civilization. The case for social democracy is fatally weakened by the concession that it requires that ten percent of population remain idle, or be forced to labor off the books in the gray
The emerging model of European capitalism

Ordinary Europeans do not find this attractive. They prefer politicians who promise jobs. This is what made it possible, until the winds of war began to frighten people, for the conservative Prime Minister of Bavaria to run a close campaign against the socialist Federal Chancellor of Germany on the ground of a promise to reduce unemployment. The absurdity of this position is self-evident when one examines the actual policies on offer by the CDU. But the claim appeared credible mainly because of its ability to make reference to the supposed facts of the "American Model" and their supposed application to the Bavarian case.

It is equally ineffective for the European Left to defend Europe by decrying the social evils of the American Model. The image routinely conjured for this purpose - of an economy of wage slaves and debt peons dominated by tycoons and maintain by racism and violence and mass incarceration - is plainly false as any ordinary traveler to the United States can see. Real wages in the United States are high. Homes are comfortable - and some seventy percent of American households own their own. College degrees are held by over a quarter of the adult population; some college education has been experienced by nearly half. (No European country save the Netherlands approaches these figures.) Even health care, on which Europeans pride themselves, is abundantly available in the United States, where the urban landscape is everywhere flecked with hospitals and clinics. Poverty among the elderly is low in America, and most seniors enjoy the independence of living on their own, often in the benign climate of Florida, California and southern Texas. In Southern Europe, the elderly overwhelmingly live with their families - if they are lucky enough to have them.

Moreover, with unemployment low and jobs plentiful as recently as two years ago, American real wages were rising, crime had declined, and most working Americans were reasonably contented. This is a major part of the reason why, in spite of a widely criticized campaign, Vice President Al Gore was elected President of the United States in the year 2000, with a plurality of over half a million votes and a larger total vote than any President-elect in history, except for Ronald Reagan himself in the boom and landslide year of 1984. The fact that the election was later stolen from Gore by the Florida political establishment and the Supreme Court cannot gainsay this achievement.

By reacting to America through Reaganite perceptions, Europeans cut themselves off from a correct understanding of the keys to the American boom. This will prove an embarrassment - to the extent that propagandists can be embarrassed - to those on the right. They will be obliged to change their account now that it is apparent that the boom has ended. But the more serious problem is suffered by the European progressives, who by virtue of their position arise cannot draw on the actual sources of recent American success. Progressives therefore find themselves caught up in the advocacy of placebo policies made popular in the United States itself under the general rubric of the Third Way. This may lead (and indeed in recent years has led) to the election of center-left governments in Europe. But it cannot lead to their subsequent economic or political success, for the notoriously simple fact is that placebos do not have medical benefits other than psycho-therapeutic.

So what are the foundation stones of the "actually existing American model"?

It is useful to approach this question by applying an idea familiar to students of Central and Eastern Europe in the late years of communist rule. This is the concept of the "soft budget constraint," widely attributed to the Hungarian economist Janos Kornai. The notion of a soft budget constraint described the condition of state-owned heavy industry under the communist regimes: entities that could not make profits, could not compete on international markets, and yet were so central to the social fabric of the system in which they were embedded, including its provision of social services, that they could not be allowed to fail. These entities became widely deployed dependencies of the state budget and the state banks, and of course in many cases they collapsed with the regimes of which they were part. In retrospect, they are quietly (and in Russia, not-so-quietly) mourned by many. To millions, they provided the rudiments of a comfortable and secure life, the threads of which have not been picked up in the post-socialist orders that since emerged world.

Which institutions? The keys to the American model lie in those sectors providing social amenities to the middle class. Health care. Education. Housing. And pensions.

Health care, in the United States, consumes some thirteen percent of GDP. A typical figure in Europe is eight to ten percent; in the UK the number is 7.3 percent. What few Europeans understand is that health expenditures within the direct U.S. government budget consume 5.8 percent of GDP. But whereas in (say) France this proportion of total out-
put supplies medical services to the whole population, in the United States the direct public commitment is only to the elderly and disabled, the poor, and to veterans. For the rest of the covered population, medical care is paid out of private insurance, which enjoys tax advantages. Overall, the tax-financed share is just under sixty percent of total health expenditure, or nearly eight percent of GDP (Woolhandler and Himmelstein, 2002).

The scandals of American health care do not lie in insufficiency of care (quite the reverse!), but rather in two notorious facts. The first is that some forty million persons lack either public or private insurance. This part includes many Latino immigrants, who tend to avoid contact with the welfare system, as well as younger working people. Hence, deficient pre- and perinatal care is an important problem. The second is the rapacity of the private actors in the system - drug producers, doctors, nursing home operators, and insurance companies notably. There is no doubt that a similar effective quantity of medical care could be provided for much less money, under some ideal system. Nevertheless, it is precisely the presence of those actors, and their political power, that has made the American health care system into the economic powerhouse that it is.

Higher education in the United States consumes about two and a quarter percent of GDP. The figure for European countries is typically closer to one percent. Again the U.S. spends more on public higher education as a share of GDP than do most Europeans: 1.07 percent as compared 0.97 percent in Germany or 1.01 percent in France. But then in addition there is the private share, another 1.22 percent of GDP, centered on institutions whose multi-billion dollar endowments are highly motivated by the tax system. Fully public institutions however dominate the scene in most of the country. For instance, over eighty percent of university enrollments in my famously "free market" state of Texas are in state institutions, financed by land grants that proved, fortuitously, to be rich in oil. Public and private institutions alike receive federal research grants, contracts and student loans.

The economic and socializing role of the American university system receives too little attention among foreign observers, who tend to follow a narrow production-function framework in assessing the contribution of extra years of schooling to the acquisition of "skills." This is a nebulous construct at best. And it is only very loosely related to what American universities actually do. The true role of this sector is much better understood by examining its contribution to the demand side.

First, there is the competence building and social cohesion entailed in the education level of the population as a whole. Just under twenty-six percent of the adult population of the U.S. has a four year university degree or better, a figure that owes its origins to the postwar GI Bill and to the late 1950s McGovern Act. This population is, essentially, ipso facto qualified to participate in the economic life of an advanced credit economy. Having had education loans, it is eligible for mortgages and for the entire spectrum of access to private credit. It is presumed competent to navigate the tax and subsidy system, to take advantage of credits, deductions and guarantees. It is also presumed competent to consume advanced durable consumers goods, from private homes to automobiles to personal computers and telecommunications devices. And, of course, it does so.

Second, there is the direct effect of higher education on employment and labor force participation. It is not easy to obtain full measures of strictly public spending on universities in the United States, in part because public university funding is a complex amalgam of federal, state, local and private flows, and partly because ostensibly private universities run substantially on public subsidies, on the huge incentive effect of the charitable deduction and the estate tax, and on publicly assisted student loans. But the higher education sector in the United States is very large. It employs a great many people, including of course large numbers of the intelligentsia, who are thus kept contented and busy. Even more important, it maintains a great many young people off the labor market, many of whom in Europe would spend their late teenage years in the ranks of the jobless young. The psychological benefits of legitimated idleness and of the rituals of accomplishment provided by colleges and universities at this stage of life should not be underestimated.

The United States maintains two alternative public systems for keeping otherwise difficult to employ young people away from unemployment. These are the armed forces, with several million members, which consumes four percent of GDP and provides competent mechanical training to its members (including to virtually the whole of the population of commercial pilots, for example). And there is the prison system, whose much-expanded role in recent years is deplorable, but whose economic function is not altogether dissimilar in some respects. (Still, it is not the case, as some have alleged, that the prison population masked a huge problem of "hidden unemployment" in the United States in the late
1990s. There was a labor shortage at the time, and many of those in prison would not have been jobless had they been free. A major difference, of course, is that these three institutions provide very different levels of access to credit and other participatory mechanisms in later life.

Consumption of housing services accounts for about nine percent of US GDP, while residential construction accounts for another four percent. The housing sector exists on its present scale thanks to a vast network of supporting financial institutions, all subject to federal deposit insurance, and to the secondary mortgage markets provided by quasi-public corporations (Fannie Mae, Ginnie Mae, Freddie Mac). In recent years, such measures as the Community Reinvestment Act (which my home state senator and fellow economics professor, Phil Gramm, has described as “worse than slavery”) have tended to oblige private financial institutions to reduce the amount of redlining they would otherwise have engaged in with respect to ghetto neighborhoods, and so to extend credit to poorer communities where their historical presence had been largely predatory. As a result, interlocking patterns of economic development begin to occur, external diseconomies associated with urban poverty are reduced, and the prevalence of home ownership rises. This phenomenon has been called “the social construction of creditworthiness” by the economist Gary Dymski of the University of California at Riverside, a close student of credit flows in the economic kaleidoscope of greater Los Angeles.

It is true that the housing finance system is the source of major problems. The crisis of the savings and loan institutions in the 1980s stemmed from two sources: the effect of high interest rates on a sector whose income was largely in fixed-rate mortgages, and which therefore fell into insolvency by the late 1970s, and the emergence of a powerful, politically well-connected clique of criminals who pursued and exploited deregulation in order to loot the corpses of these failing institutions. The lawyer-economist-criminologist Bill Black has coined the term "control fraud" to describe this pattern of behavior, and views the pattern of the savings and loan debacle as the model for such more recent disasters as Enron and WorldCom. Nevertheless, the fact remains that most Americans grow up in their own homes, and that for the present moment the rise in home equity remains the major collateral against which middle class Americans are able to borrow to support their continuing and growing levels of consumption. We shall return to this point.

Finally, Social Security payments to the elderly and disabled together with public pensions account for another eight percent of US GDP. On the reasonable assumption that these transfers are substantially spent rather than saved by their recipients. Social Security alone provides the major source of disposable income of sixtyfour percent of American elderly; only the top forty percent of that population group has substantial other sources of income, public or private. The typical social security payment for an elderly couple in moderate health can approach twenty thousand Dollars per year, which when combined with Medicare is adequate for modest comfort in most of the country. Pockets of elderly poverty remain - single women with little work credit can be in trouble - but it is important to emphasize that these are pockets, not reservoirs, of poverty. All in all, poverty among the old in America has fallen dramatically since the early 1970s, and is now lower than among the general population. This is the accomplishment substantially of expanded social security pensions.

Social Security has been under attack in recent years, and especially so under the Bush administration, for a straightforward reason. Exactly as with the savings and loan debacle of the 1980s, sharp private financial operators have seen the opportunities inherent in diverting the cash flow of the public trust funds into private investment accounts. Such accounts would create, overnight, millions of inexperienced and hapless investors, whose accounts could be manipulated and against whom fees could be charged essentially at will. The campaign to privatize Social Security reached a high water mark in the immediate wake of the stock market run-up of the late 1990s, when it was possible to argue that the future elderly were making a bad investment with the social security payroll taxes. This argument has since completely lost weight, owing to the stock market collapse and the general disrepute into which brokers such as Merrill Lynch have rightly fallen. Mr. Bush's Social Security "Reform" Commission disappeared without a trace. The campaign has since gone underground – the Republican Campaign Committee has purged the word "privatization" from the lexicon of its candidates in the 2002 election. It will resurface only if the fortunes of the Republican Party are revived by war and terrorism. Otherwise Social Security will remain a public system in the United States.

Add these elements together, and they account for just under forty percent of total consumption of goods and services in the United States. Moreover we have not included the direct contribution of non-
military public expenditure at the federal, state and local levels, which amounts to another fourteen percent of GDP. Of this, a bit more than two percent is activity directly undertaken by the Federal government; the rest is spent by state and local governments. And of that, a high fraction goes for public education. Over eightyeight percent of American schoolchildren attend public schools, and that proportion has not fallen in recent years. Efforts to undermine public education in America, for instance by privatizing public school systems or providing vouchers to permit relocation of children away from weak schools, represent so far only a very tiny fraction of total public education expenditures. They receive a great deal of media attention because of the natural bias of a private media in favor of private initiatives, but they have never enjoyed widespread popular support - even in Texas.

All in all, the public sector underpins in one way or another activity in well over half of the American economy, and in so doing helps to sustain and to stabilize the growth of the economy as a whole. The margins of American politics involve battles over the boundaries between public and private control. Deregulation of transport, telecommunications and energy markets in recent years, reduction of public housing and welfare aimed at the poor, and the so far unsuccessful assaults on public education and social security represent advances and victories for private interest. Expansion of the Earned Income Tax Credit after 1993 and a large expansion in the payment of disability benefits under Social Security in recent years represent movements in the other direction; and together they outweigh cutbacks in the traditional welfare program, Aid to Families with Dependent Children (now converted into a block grant to states called TANF - Temporary Assistance for Needy Families) – though obviously not always going to the same people. In the 2000 election campaign, a key issue was the expansion of health care benefits to cover prescription drugs for the elderly - an increasingly important component of their health care costs. Not all movements in American politics, even now, cut against the public sector.

The point to emphasize here is not that the United States is full of hospitals, universities, housing and pensioners. So obviously is Europe. The point rather is that in the United States these sectors are funded by a bewildering variety of financial schemes, involving public support in myriad direct and indirect ways, including direct appropriations, loans, guarantees, and tax favors. Thus the control of the scale of these activities has largely slipped away from the authorities who control the public budget. And this is the genius, if one may call it that, of the American Model. The soft budget constraint (which as recently as the 1960s was entirely the province of the military) has come to apply precisely where it can do the least harm - in providing income and employment in sectors that provide universally demanded human services to the population. In other words, powerful political constituencies exist to keep these sectors at the forefront of American life, and it is very likely that they will remain there.

One gets the impression that this is not the case in Europe, where health, higher education, housing and pensions all remain substantially under the control of state budgets. This accounts, in part, for the higher share of European GDP measured as passing through the government sector. But it also helps to account for the difficulties Europe experiences in absorbing its employable population. Public sectors are subject to hard budget constraints. And where the public sector is given a near-monopoly in the provision of a service (such as health care), then the private sector is forced to operate in other sectors – protected private retail shops and small farms, for instance – that may not enjoy comparable income elasticities of demand. The American system of dual systems of finance is far less efficient, to be sure. But it absorbs many more individuals into gainful employment. Moreover, as European national budgets come into conformity with criteria established by the European Union, then expansion of human services becomes more difficult, rather than less so.

The rise to full employment in America in the late 1990s occurred in major part because of a very steady expansion of the quasi-public sectors, in spite of the fact that the formal federal government sector did not grow at all. (State and local governments did, in fact, expand rapidly as the boom gathered force, and major new infrastructure projects of which Boston's Big Dig was the leading example will eventually be the enduring legacy of the era.) However, the more or less predominantly private sector, specifically in high technology, also played its role, and it is worthwhile examining that phenomenon at this point.

What was the role of the Information Technology Boom that so filled the news emanating from America in the last years of the late millennium? The answer can be read from the national income and product accounts, which show that from 1997 to the peak in 2000, business nonresidential fixed investment rose by about $300 billion 1996 Dollars, a gain of about two percent in relation to GDP, or from 12.3
The emerging model of European capitalism

has been on the order of $150 billion, bringing business investment as a whole back below the provision of health care in its relation to the scale of the United States economy. The entire fall-off in business investment to date may be replaced by the increase in the military budget already requested by the Bush administration.

In terms of employment, a U.S. Commerce Department study in 2000 estimated that eight percent of the American labor force worked in the "high technology" sectors. This estimate was almost surely greatly overstated, including for example the entire employment of the media and entertainment sectors in the total. Two to three percent of total employment might have been more realistic then, and perhaps half that would be a good estimate for the situation today.

It remains true, of course, that the bubble in the information sectors contributed the final ingredient to the concoction that produced the great American boom of the late 1990s, driving unemployment below four percent for a sustained and happy period, while numerous young and supposedly glamorous business figures grew extravagantly rich. But the overall role of this sector in that achievement has been as grotesquely overstated as were its stock valuations. (As the economist Robert Barbera remarked in 2001, Cisco was never actually larger than France.) Complicit in all of that were the media, the stock analysts and the brokerage firms, and high government officials, notably President Clinton on one side (who courted high technology relentlessly for glamor and campaign funds) and Alan Greenspan on the other (who succumbed to the seduction of a "new paradigm" view, intended to excuse the Federal Reserve from blame for having tolerated high unemployment for decades beforehand). Greenspan knew there was a bubble, knew that he had the tools to control it, and failed to take the actions that prudence should have dictated.

But the bubble happened. And all together, these forces combined to generate full employment in the late 1990s for the conventional Keynesian reason: a high level of effective demand. The peculiarity of effective demand in the U.S. which seems to have eluded European observers, was that while much of it was generated or encouraged by acts of public policy, most was not registered on the public balance sheet. Thus the U.S. achieved full employment not only with formally balanced public budgets, but with recorded surpluses. One might call this the Keynesian Devolution. Left unstated are the implicit financial liabilities of the public sector on behalf of businesses and households. These were the powerful new Keynesian mechanisms of the new economy in America, just as essential as recorded budget deficits were to Keynesian policy in the days before credit markets had reached their present scale.

The problem of the Keynesian Devolution lay, not in its efficacy as a mechanism for growth and prosperity, but in the fact that its implications for the balance sheets of the household sector cannot be sustained. As Wynne Godley has emphasized in a series of papers, the American household sector has been spending ahead of its income relentlessly since 1997. Debt ratios to income have risen well above historic highs. The net negative acquisition of financial assets peaked at around three percent of GDP in 2001, and has since been falling sharply, a process known as reversion. For the moment, only a continued willingness to borrow against the value of housing appears to be holding the American consumer up - and this is, of course, a very risky business for homeownership in the long run. Once that ends, as households cut back on spending in order to bring their outlays in line with their (declining) incomes, a prolonged period of stagnation, if not recession, cannot be avoided. Unless, of course, the administration manages to embroil the country in a suitably expensive war.

A reversion toward historical norms in saving and spending behavior was already underway in the United States before the traumatic events of September 11, 2001. At the moment that crisis hit, an almost universal view held that it would drive the economy into recession. In fact, as revisions to the economic statistics later demonstrated, the economy had already been in recession for three quarters. And in the aftermath of September 11 there came policy changes which produced a rapid return to economic growth by the end of the year. These included the tax cuts (already enacted but not yet in effect) which included a cash rebate to most taxpayers, spending increases for war and relief, rapid cuts in the interest rate, a reduction in world oil prices and a massive inventory liquidation by automobile manufacturers. These together help lift the economy in the fourth quarter of 2001 and the first quarter of this year, providing the professional chorus of optimists in the financial profession with their evidence that full employment prosperity would soon return.

Unfortunately, these direct Keynesian measures were all temporary in their effect. The tax rebates have been exhausted; the government’s relief spending has been done. Interest rates have not been cut...
further - indeed there is not much left to cut. Oil prices have returned to pre-September 11 levels. Only the automobile companies have continued to provide bargains to consumers while maintaining output and employment, and one has to wonder how long they can carry on in such a fashion.

Furthermore, the new fiscal year has dawned badly for the state and local government sector, which continues to operate under quasi-hard budget constraints imposed by constitutional balanced budget requirements. For the most part, states and localities were able to keep up activity levels to date through the depletion of financial reserves, but that moment is largely past. States that relied heavily on capital gains taxes and income taxes on stock options realizations are in a very bad shape at the moment. In particular, the state of California alone faces a budget gap most recently estimated at near twentyfour billion Dollars, out of general revenue fund of eighty billion Dollars last year. Overall estimates of the state budget gap If states and localities cannot avoid cutting their spending or raising taxes, they could deplete another one hundred billion Dollars from the spending stream in the year ahead.

Thus the American Model is entering a moment, even a prolonged phase, of crisis. This crisis is, however, mainly owing to the behavior of sectors where budget constraints continue to bite. These are, first, the business investment sector, which is affected by the virtual disappearance of retained profits. Second, the state and local government sector, which is constrained to spend within its means. And third, looming over all, the household sector, which may soon enough fall victim to a combination of its own financial prudence and the closing of lending windows. The soft budget sectors, including health care, higher education, housing, the military, and pensions, continue for the time being to fuel continued expansion.

In all of this, then, in the great rise of America toward full employment and in the subsidence of the past two years, what has been the role of the vaunted flexibility of American labor markets? The answer is straightforward: no role at all. American labor markets did not become more flexible as the economy approached full employment in the late 1990s. And they have certainly not become less flexible in the present recession.

Indeed, measurements of pay inequality in the United States show, unambiguously, that structures of pay became substantially more equal as the 1990s progressed and unemployment declined. The U.S. did not approach full employment by increasing inequality: on the contrary, the relevant form of inequality declined. This fact was deeply obscured in most people's perception by the rise in household income inequality - a very different matter which owed in part to changing family structures and in part to the boom in the stock market and capital gains income.

Moreover, the late 1990s also demonstrated the trivial role played in the employment picture by such measures as job retraining and lifelong education programs. Such policies had been in place since the early 1980s, without noticeable effect. It was only when labor demand rose to full employment levels that unemployment disappeared. And then, of course, by far the largest fraction of the new jobs went to people who had never taken part in any training program.

Further, in earlier work I have argued that the much-repeated comparison of inegalitarian, full employment America with underemployed, egalitarian Europe was and is an optical illusion, based on a misperception of the appropriate boundaries. It is true that the United States is substantially more unequal than the countries of Northern Europe, and somewhat more unequal, by most measures, than the countries of Southern Europe. But these pairwise comparisons ignore the component of inequality contributed by differences in average pay across European countries - differences which remain far more substantial than comparable differences across American states. When these are taken into account for industrial pay, using the OECD's Structural Analysis data set, we find pay inequalities to be higher for Europe as a whole, than for the United States. Thus we conclude that unemployment and inequality are not substitutes but complements, when measured at the appropriate level of geographic aggregation. And the distribution of unemployment across Europe - higher in the poorer and more unequal countries - emerges as simply an artifact not of inflexible labor markets in poor countries but rather of the simple fact that Europeans, when they are unemployed, prefer to be unemployed at home. This phenomenon can be remedied only by providing jobs, either in situ, or else in richer countries toward which Europe's poor will eventually migrate if nothing is done for them where they live.

What then for Europe?

A comprehensive approach to European unemployment must produce a consistently higher rate of economic growth, aimed at absorbing 30 to 35 million
Europeans into gainful employment, and particularly in the lower-income regions of Europe where unemployment and subemployment are pandemic.

How is this to be achieved?

Part of the answer must lie in the orientation of macroeconomic policy. American monetary and fiscal policy remain governed by the 1978 Full Employment Act, and the political economy of the U.S. does not tolerate the sole focus on inflation that is the obsession and constitutional mandate of the European Central Bank. To achieve higher economic growth, the objective of full employment must be part not simply of the European Charter but a core macroeconomic policy objective of all policymaking institutions. This includes the fiscal authorities and the central bank. It must be more important in practice than either price stability or fiscal balance, and the authorities must recognize that fiscal balance is a consequence, not a cause, of full employment.

Expanded credit access, through loan guarantees, home-buyer subsidies and secondary mortgage markets, can help distribute the burden of increasing effective demand over the private sector. It seems likely that some part of the sharp reduction in unemployment in Spain following currency unification – from 20 to around 12 percent – owes to the reduction in credit risk associated with the transition from a devaluation-prone peseta to the Euro, which reduced the bias toward tradeable goods in the composition of Spanish output, and facilitated the financing of enterprises in the services sector. However, it should also be recognized that this aspect of the "American solution" – and particularly unsecured consumer credit – is unstable. Europeans would be wise to encourage a build-up of private-sector debt on the American scale or excessive reliance on this one instrument.

It is better to raise incomes. Unlike the United States, Europe lacks retirement systems on the continental as opposed to the national scale, with consequent weak purchasing power of elderly and other economically secondary populations (including non-employed women). In particular the elderly residents of poorer European countries remain poor by European standards. This is manifestly unjust, and it is also uneconomic. The remedy is to move toward a Europeanized pension system, that would pay all European elderly on the basis of continent-wide average productivity. Why in an integrated continental economy should a Portuguese worker be obliged to retire on a pension set by past average productivity in Portugal alone? His or her home might be right alongside that of a German or Dutch retiree whose payments, after a lifetime of equivalent or easier labor, amount to much more. The EU should begin the task of leveling up pensions. On similar ground it could also implement a system of topping up pay for the leastwell paid members of the Euro work force, analogous to the U.S. Earned Income Tax Credit.

There are also large areas of public or quasi-public social commitment in the United States that are comparatively underfunded in Europe. Europe funds certain sectors very well – public transport, for instance, at least by U.S. standards. But an examination of European employment patterns compared to the U.S. reveals the key compositional or structural issue: an "across-the-board shortfall" in services employment in Europe. As European Commissioner Diamantopoulou has correctly stated, this covers every area, from "business services to health and education."

In higher education, one step toward a solution seems clear to a trans-Atlantic observer. Why can’t Europe begin to emulate the American university system? There are virtually no pan-European universities; the creation of even a handful of major EU-funded institutions strategically located in Greece, Portugal, southern Italy and Spain - as well as Eastern Germany, the Czech Republic, Hungary and Poland - could have significant effects on regional development patterns and also, ultimately, on continental integration. The competition from European institutions would force upgrading of existing national universities, all underfunded by American standards. Clearly, this (and not training programs) is the key to the knowledge base. And the key to a university system is money; not only through public grants but through private charitable donations, strongly incentivized by the tax system. A European wealth tax with targeted charitable deduction provisions for universities - perhaps favoring transnational institutions – might do wonders for higher education in Europe.

In health care, Europeans have long had a superior mechanism for insuring access to health care, and perhaps also for managing the delivery of services. But, as noted above, they do not provide care itself on the American scale. Major improvements in European health facilities could be funded by the EU with special emphasis on lower-income regions. Perhaps equally important would be an expansion in facilities for the care of the infirm elderly, whether in institutions or simply employing trained professionals to assume part of the burden of caring for them in their own homes.
In sum: Europe needs public investment, private credit, and direct transfers to lower income populations, both working and non-working. Europe needs, in short, softer budgets in strategic sectors, to redevelop the mechanisms of the welfare state, which were pioneered in the postwar period, from the national to the continental scale. This is the antithesis of the current conservative prescription. But the American experience stands as evidence that it is the prescription that works. As we have learned, these measures are not, in the economic sense, transfers from the rich to the poor. They are rather the use of appropriate means, to mobilize otherwise unemployed resources in poor and otherwise fiscally incapable regions.

It would be nice to imagine that Europe might move smoothly back to full employment under the influence of purely European models. But so long as European policymakers remain fixated on labor markets and sound finance, these models are not going to work. Meanwhile the American model as it really exists is also worth European investigation, notwithstanding its current troubles. It is clear enough to most Americans that the only way out of our current troubles is through expansion of the public and quasi-public instrumentalities we already have - a further Keynesian Devolution. And it may well be that the path to European full employment lies partly through the mechanisms pioneered in the American New Deal.

Reference
Abbreviations

CAP Common Agricultural Policy
CEECs Central and Eastern European Countries
CIS Commonwealth of Independent States
CMEA (COMECON) Council for Mutual Economic Assistance
CSFR Czechoslovak Federal Republic
EAGGF European Agriculture Guidance and Guarantee Fund
EBRD European Bank for Reconstruction and Development
ECB European Central Bank
ECE, UNEC United Nations Economic Commission for Europe
EIB European Investment Bank
EMS European Monetary System
EMU European Economic and Monetary Union
EP European Parliament
ERM Exchange Rate Mechanism
ESCB European System of Central Banks
EU European Union
EWG Europäische Wirtschaftsgemeinschaft
FDI Foreign Direct Investment
FRG Federal Republic of Germany
GDP Gross Domestic Product
GDR German Democratic Republic
IMF International Monetary Fund
MFN Most-favoured-nation
NCB National Central Bank
PAYG Pay-as-you-go-System
PPP Purchasing Power Parity
PPS Purchasing Power Standard
SGP Stability and Growth Pact
WTO World Trade Organisation
ANDOR, László (Hungary) is associate Professor at the Budapest University of Economic Sciences and Public Administration, Department of Economic Policy, and editor of the political and social science quarterly Eszmélet

BÖMER, Hermann (Germany) is Economist at the Universität Dortmund

BORCHARDT, Andreas (Germany) is Economist at the Universität Dortmund

DAHLSTRÖM, Gösta (Sweden) is Research Fellow at the Fackföreningsrörelsens Institut för Ekonomisk Forskning, Stockholm

GALBRAITH, James K. (USA) is Lloyd M. Bentsen, jr. Professor of Government/Business Relations at the Lyndon B. Johnson School of Public Affairs, the University of Texas at Austin, and a Senior Scholar of the Levy Economics Institute

HUFFSCHMID, Jörg (Germany) is Professor of Economics at the Universität Bremen

KOWALIK, Tadeusz (Poland) is Professor of economics & humanities, Institute of Economics, Polish Academy of Sciences, Warsaw, and School of Social and Economic Studies

LÓRánt, Károly (Hungary) is Vice-President if the Hungarian Civil Society Council

MATZNER, Egon (Austria) is Professor of Public Economic, Vienna University of Technology

MENCINGER, Joze (Slovenia) is Professor of Economics and Rector of the Univerza v Ljubljani

MORVA, Tamás (Hungary) is an Economist and a former director of the National Planning Institute (Budapest) and a former director of the Projections and Programming Division of the Economic Commision of Europe (UN, Geneva)

OKÁLI, Ivan (Slovakia) is Economist at the Institute of Slovak and World Economy, Slovak Academy of Sciences

SAMARY, Catherine (France) is Economist and Balkan specialist, and a regular contributor to the Monde Diplomatique

SCHLEGEL, Wolfgang (Germany) is Economist at the Universität Dortmund

ŠIKULA, Milan (Slovakia) is Director of the Institute of Slovak and World Economy, Slovak Academy of Sciences

THOMASBERGER, Claus (Austria) is Professor of Economics at the Vienna University of Economics and Business Administration