Europäische Integration als ordnungspolitische Gestaltungsaufgabe

Probleme der Vertiefung und Erweiterung der Europäischen Union

Von

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On the EU-Maturity of Central Europe: Perceived and Real Problems *

By László Csaba, Budapest (Hungary)

A. Introduction

Enlargement of the European Union is a broad issue of prime politics. What countries to admit, how and when, under what conditions will have long been debated before any accession materializes. These issues and the related argumentation, conducted at the policymaking level are subject of a different paper of this author (Csaba 1998). The present piece is devoted to some of the more philosophical issues to be tackled at a different level of abstraction, that of applied economic theory. It relates to three most likely candidates for Union membership: Poland, the Czech Republic and Hungary, as reflected in the Commission's AGENDA 2000. These are called – in a somewhat arbitrary fashion – as Central Europe, in order to delineate them from less advanced transforming countries, that are not yet members of the OECD club of market economies. The paper is not empirical, but is meant to address a single, weighty theoretical issue: is the above described narrow Central Europe (with the possible inclusion of Slovenia) mature for a full Union membership by the first years of the n ew millenium? Is there an answer based on economic theory, rather than political tastes, to this question?

This paper was written at a time when the NATO decisions of Madrid as well as the official presentation of the axis of the Commission have by and large settled the dispute over the possibility of an eastward enlargement of Euro-Atlantic structures. Debates from now on will concentrate on the ways and means, scope, speed, and other circumstances of enlargement. Thus it seems legitimate to skip what initially used to be the topic of a large body of literature, i.e. whether it is in the interest of either side to enlarge, and if yes, why and when. I take it as given that any such step is that of strategy, therefore its bits and pieces, taken one by one, do not add up to their structure. If the underlying logic is abstracted away, as in a part of more technical writings, the individual measures and their supportive arguments remain just as inconclusive.

* At the time of writing the author was visiting professor at the Frankfurter Institut für Transformationsstudien, Europa Universität Viadrina, Frankfurt/Oder. Useful comments by Brucker, H. / Kelte, J. / Schmitt, W. / Wilgeroth, H. are appreciated, with the usual cautions.
as individual human gestures torn out of their context. The mutual commitment here is thus — first — taken as given. Secondly, I also abstract away the comprehensive issues of whether, when and how the Community is able to absorb new members, further if the institutional and other reforms contemplated currently suffice for an efficient mastering of the task. This is also taken here as given, although — as I tried to argue elsewhere (Csaba 1997) — it is practically far more relevant a precondition for enlargement than any other single issue. The angle of analysis remains narrow and one-sided, with an exclusive focus on the readiness of the frontrunners transforming countries for eventual Union membership. A third, no less important topic to be assumed away is that of not (yet) members, as well as problems related to Russia, Ukraine and all of the post-Yugoslav states except Slovenia. The latter is a practical matter, and provided the theoretical structure of the analysis below is sound enough, the findings may be generalized so as to contribute to setting the conditions for possible future decisions on enlargement, as well as clarifying its limitations. Fourth, I also mostly disregard otherwise weighty issues of public choice for Central Europe, i.e. whether current EU arrangements are necessary and sufficient conditions for laying the groundwork for their sustainable development. Low growth coupled with high unemployment in the ‘target zone’ may legitimate such theorizing. But for the present purpose the Europe Agreements as binding international contracts, are accepted in which would-be members already in 1991-92 compelled themselves to take over the (present and future) acquis communautaire rather than criticize it. If these are seen as irrational or triggering intolerable costs in case of enlargement, this is just another urge for internal reforms rather than to deny the feasibility of enlargement, on the dubious methodological ground of a status-quo extrapolation. For the present paper it is assumed, that a solution to this challenge can be, and indeed will be, found either via more spending or — more likely — by trimming previous entitlements when the new financing guidelines for the post-2000 accession period will have been set. The ways and means of attaining this goal also fall outside the scope of the present exercise, which is the fifth relevant explicit assumption/limitation of our reflections here.

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1 Bringing a bunch of flowers may or may not represent a gesture of deeper sympathy, depending on the situation. Similarly, bringing debt: GDP ratios down may or may not be a condition for integrational maturity.

2 This feature is sometimes seen as newcomers’ perceiving the EU as the seventh heaven, which is, of course, wrong.

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B. Is the Conventional Wisdom Full of Misperceptions?

If there is anything like ‘conventional wisdom’ on the eastward enlargement, this is a — mostly imprecisely formulated — impossibility theorem. Contrary to ‘high-flying’ politicians ‘down to earth’ economists regularly produce arguments why Central Europeans could not, should not, or should not even want to join in, despite the explicit deliberations and the careful wording of the Treaty of Rome (on the latter cf. Balázs 1996, Part I).

The classical summary of all possible arguments against an eastward enlargement is still the well-argued book of Baldwin (1994). Among many, partly valid and sophisticated, arguments the main thrust of his reasoning is that these countries are too poor, too populous and too agricultural to join. In a footnote, the author himself concedes that these ‘may not fully hold’ for those 3 or 4 countries, which currently stand a good chance for being in the first round of Union enlargement. Using purchasing power parities rather than grossly and intentionally undervalued exchange rates, taking into account the very large irregular economies, as well as the impressive performance in the 1992-97 period, one cannot seriously believe that the Czech Republic would need 5 more years to catch up with Portugal or Greece. Population may be a problem if Ukraine and the Balkans are covered (as by Baldwin). With the frontrunners only we face a 65 million population, quite in line with the Southern enlargement, which a then much poorer Community managed with reasonable success (Pálánczai 1997). Finally the 4-6 percent share of farming in GDP in the Czech Republic, Hungary and Poland is actually not that dissimilar from Southern EU members’ ratios.

The problem of agriculture can be seen as a problem or a chance (Varga 1992; Franke 1997), as taking over the 1991 CAP could, indeed, have produced unprecedented surpluses in the farming sector. However, this is an unrealistic assumption. First, producing capacities in would-be members dramatically decreased against, say, the mid-80s. Second, CAP reforms along the MacSharry lines are already making way and will be inevitable under the 1994 WTO agreements. The forthcoming WTO round will surely invalidate any assumption extrapolating 1991 (or 1997) arrangements for the post-accession period. Third, even if the EU funds were theoretically available, the absorption capacity of the new members would be limited to draw all entitlements (Wagener / Fritz 1996). As signatories to both WTO treaties Central

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3 Short of a — currently unlikely — territorial settlement on Cyprus and a more forthcoming attitude of Slovenia the accession of these countries seems unlikely. Viktor Chernomyrdin’s 1997 Paris statement was the first indication of Estonia’s improved chances, though the Baltics do pose a special problem. For a similar unofficial view of the Commission cf. also Die Welt, 11 July 1997.
Europeans have already been forced to cut production and export subsidies and manage painful structural adjustment processes in their farming sectors. Following accession competition is likely to crowd out further parts of local output from their traditional domestic markets, which is not exactly the base scenario for a boom in the agricultural sector.

The poverty argument seems to have taken root much more than established trade theory or neoclassical growth theory would have justified. Both different factor endowments and the theory of endogenous growth prognosticate higher, rather than lower, growth rates for latecomer economies. This applies a fortiori if trade liberalization and market size considerations are available (as in case of EU enlargement). Disregarding these fairly unsurprising and not exactly new findings two alternative views took hold. One brand is that of convergence programs (Ludlow / Gros 1993). These simply switch off the entire mechanism of catching up and the political economy of orchestrating measures leading to it. They turn the question to its head by asking: how many years would it take for candidates to reach, say, 75 p.c. of EU-average levels? The answer is certainly biased downwards, at least for two reasons. First, it disregards the very large and palpable growth impetus of FDI that a mere prospect of membership may, and indeed will, trigger. Therefore domestic savings cease to be a compelling constraint on growth acceleration. Second, transformational recession (for details cf. Kornai 1994) was a temporary and unique phenomenon in 1989-92, having depressed initial levels and expectations away below the realistic catch up potential. Last not least self-propelling catchup due to institutional reforms and relocation of activities is already well underway, but not independent of integration at the macroeconomic level. In sum, a convergence program would like to see the outcome as a precondition, which is certainly the reverse reasoning. Unsurprisingly, authors of this line normally do not see how their maxims could (or ever will) be attained, as the very driving forces that may actually deliver this outcome are neatly abstracted away.

An alternative view in the same line is the argument on agglomeration effects (Tichy 1997). In this approach both central and peripheral regions have a tendency to multiply and enforce their previous position. Thus any integration of the periphery presupposes a.), limitations of labor mobility (cf. below) b.) enhanced transfer spendings to ward off mobility. This new edition of Marxist economics disregards such fundamental facts of life as the emergence of two dozens of newly industrialized countries and the decay of some of the old metropolitan areas. There is little empirical and even less theoretical evidence that would lend support to this line of reasoning, besides the arbitrary assumptions built in the underlying models. Hong Kong, Taiwan or Singapore did not always used to be financial and services centers, and Belgium is certainly not what it used to be, neither is the US East Coast. In fact, while the arguments why trade liberalization and market integration is always welfare enhancing are rather standard textbook knowledge, supported by microeconomic (networks, industrial organization) considerations, the contrary reasoning is simply widespread, meanwhile hardly compelling. If anything the experience with German reintegration has proven that the way through enhanced transfers cum regulated labor markets leads to an emergence of a Mezzogiornotype of rent-seeking society, rather than to an accelerated catch up in the real world (cf. also von Hagen 1995).

There are two further subdivisions or extensions of the poverty argument. One forecasts massive migration of people: a recent estimate for instance puts the potential to 340 to 680 thousand people from CEFTA (Bröcker 1997, p. 94). This finding may be easy to instrumentalise at the political level. Moreover, compared to other forecasts, as those of the IMF, EBRD or EUI, it seems to underestimate the medium-to-long-term growth potential of the region. This finding also seems to be at odds with empirical experience in the EU of the 70s and 80s with lower propensity and possibilities for moving over. Linguistic and cultural barriers, repatriation as well as labor market and residence permit measures all resulted much less flexibility of this factor than suggested above. Concurring analyses of US and EU empirical time series of the 1950-90 period (Görgens 1993) have arrived to elasticities of about one third of what the above quoted study relies upon. My point of criticism, however, is not directed to the econometric technique, to the numbers or its policy implications. Let us suppose: this is the final word in an ongoing international controversy. Even then, numbers must be interpreted in a macro context. And after all: should 0.5 mm people actually resettle to a community of over 350 mm - would that really be a serious external shock at the macro level? And if yes, is it the supply or the demand side that calls for a radical treatment? In a technical argumentation it is hard to sell an argument depicting a mere 0.5 p.c. change as a serious external shock, even on the labor market.

A revised and extended version of the poverty argument goes as follows. Hardpressed by their current account crises transforming countries have malm- adjusted their economic structures by opting for low wage policies and currency under-valuation. The resultant resource intensive export structures will be lastingly uncompetitive on the international markets (Gabrisch 1996). Joining this line others caution of a 40-60 p.c. jump in consumer prices, and the resultant cost-push inflation, should Central Europeans join in the EU (Havasi 1996).

4 Central Europeans have traveled enough in the 90s to be able to form rational expectations of their chances on say, the Spanish or the Finnish labor market. Thus migration potentials are likely to be lower than any technical figure would suggest, since the high rejection probability invalidates the use of those USA elasticity coefficients, that Bröcker (1997) relies upon in his econometric analysis.
It has already been mentioned that the appreciation of exchange rate is, to some extent, an automatic process. Recent overviews of the export performance of transforming countries have evidenced both the quantitative and the structural advancement of the frontrunner countries (Kaminski / Wang / Winters 1996). Hungarian corporate evidence also reflects major comparative advantages in the more rather than the less skilled groups. Thus FDI strategy is one of relocating R&D and other knowledge-intensive activities, while simple jobs go to underdeveloped countries. SITC 7 group category - machinery and equipment - has climbed from 13 to 44 p.c. in Hungary's exports to the EU in the 1989-97 period. This is not the picture of eternal slavery. As far as the price adjustment is concerned it is a fact of life that most of it has already taken place, true mostly in the upward direction. But in the longer run areas with comparative disadvantages prices should decrease (Cassel 1996, pp. 160-161). They already started to do so, at least in relative terms, and where protectionist barriers do not counteract these (as in the farming, the textile or the steel sector they do). In sum, neither the misadjustment, nor the cost-push argument seems to hold for the frontrunners.

All in all, the more one believes in standard economics, and the less one takes existing arrangements reflecting casual social compromises (in East and West) for granted, the smaller is his willingness to buy the 'too poor, too populous, too agricultural' argument. By the same token the less difficulty one sees in the welfare enhancing capacities of exchanges among countries on various levels of development. True, for this one often neglected quality of modern economics is positively required: the ability to distinguish (not to mix up) macro- and microeconomic levels of argumentation, which is anything but normalcy in policy discussions. The advent of the informational and electronics revolution makes the backwardness of physical infrastructure comparatively easy to tackle by the spread of new communications techniques. The latter also favor decentral smaller arrangements and individual initiative, against the scale economies and standardization of the steel and textile period.

C. On the Meeting of the Copenhagen Criteria

In 1993 the Copenhagen Council set the criteria that are necessary for Union membership (although meeting these by no means equals to automatic qualification). Given our subject, the fourth criterion, the Union's ability to absorb new members, will be disregarded.

As far as political democracy is concerned, Poland, the Czech Republic, Slovenia, and Hungary all had parliamentary elections under international supervision, with regular and orderly handover of governmental responsibilities via new elections. Press freedoms are basically observed, nationality rights granted and bilateral disputes settled via international treaties. Unlike in the Baltics (except Lithuania), the Council for Europe has not found groups of citizens discriminated against. As far as market economy is concerned, OECD membership should suffice for testifying it. And finally the economies' ability to stand competition has also been tested by trade, market, and financial sector liberalization. Unlike Southern Europeans, transforming countries have already opened up their economies prior to the accession talks. The Europe Agreements provided for a gradual but sustaining (first asymmetric) mutual market opening. Thus by the turn of the millennium everything what the European Economic Area could have offered, will have been attained. In fact, even more! The structured dialogue, initiated by the Essen Council of 1994 paved the way for a regular interchange among incumbents and candidates way above trade issues, covering i. e. environmental, financial, security, and home affairs as well. In sum, it is unrealistic at best (and hypocritical at worst) to caution OECD member countries of a new market shock. In fact, one of the attractions of being in, rather than out, is the ability to determine the future shape of that regulatory environment which is decisive for Central Europe as an investment spot. The market shock has already occurred and the price is basically paid in the form of transformational recession and the heavy losses in economic activity rates of the population.

It is worth noting that economic recovery and reorientation of commercial relations in Central Europe materialized without those massive international transfers (a second Marshall Plan) that has repeatedly been advocated by Jeffrey Sachs and the Economic Commission for Europe. This is, on its own right, an indication of the subordinate role of intergovernmental transfers, which is quite in line with overall international experience. Thus the size of those is unduly overrepresented in the debate on enlargement. The ability to absorb foreign private investment, by contrast, is certainly a direct indicator of maturity as well as of progress in economic transformation. In a consolidated economy reliance on what is 99.5 p.c. of international capital flows should rightly take precedence over the 0.5 p.c. Thus in theory new members may well reject any transfers from Brussels, as their investment-attractiveness will automatically improve by the mere declaration of accession talks. Practically, this option is open only if everybody else rejects transfers, otherwise basic principles of the rule of law (i. e. even-handedness) would not be met. But the bottom line is that catching up is conditional upon involvement and integration rather than on the size, or even the occurrence, of unilateral transfers. The hard fact that recovery and structural change has been already mastered, without reliance on these, is possibly the most convincing argument in favor of cutting back the redistributory horse trading to its due size, also in enlargement debates.

It used to be fashionable to blame the Europe Agreements (EA) both at the analytical and the policymaking levels, basically for all economic pains of
systemic change, and also for falling short of providing full membership. In reality these have proved, with the benefit of hindsight, one of the few efficient and mutually advantageous forms of assistance to Central Europe. In the trade section, despite much of the well-known ambiguities and half-heartedness, these brought about a gradual and sustaining market opening on both sides to the degree it was possible under the given political constraints. The EU proved to be quite efficient as a means to fight protectionism whenever there was an administration, able and willing to make use of its provisions and procedures (Sapir 1995). The association council, as a regular monitoring and consultation forum, proved particularly efficient a means to counter and even roll back creeping protectionism, or in the worst case scenario, signal high - policy - level warning signals against policies obviously contrary to the spirit and prospect of accession. This was the case with ongoing Polish reliance on quotas in the steel sector, their indiscriminate use of countervailing duties in the farm sector, and the discriminatory favoring of the Daewoo on Polish car market in exchange for investment. Likewise the Czech and Slovak import deposits of 1997, the Slovak and Hungarian import surcharges of 1995 were criticized. The abolition of the latter could hardly have come about by 1 July 1997 without massive pressure from the association council, and the same is true of the Czech case, a month later.

The revamping - actually the third edition - of the law on competition has brought it fully in line with EU legislation in case of Hungary. Empirical analysis of the implementation of the deliberations of the 1995 law (Török 1997) has demonstrated in detail that it is fully in line with EU practices, which is bad news. As the study (op. cit. pp. 430-431) also notes critically, this implies notorious leniency on fusion controls and a very permissive stance on monopolies in the course of privatization. This is not a surprising outcome, since supporters of US-style trust-busting have always been a minority, therefore some tasks specific to the transition phase (in building up and preserving contestability of markets) have been unattended. A cross-country analysis of the same area (Fingleton, et al. 1996) comes to a similar conclusion for Hungary, while highlighting the major differences by the countries. As far as the other Visegrád countries are concerned, the book recurring points to the drift between the very advanced level of transplanting formal rules and regulations on the one hand, and fairly timid (if any) implementation on the other. This applies primarily to the politically most sensitive areas like trade and privatization, where competition agencies saved their integrity by simply escaping those spheres. This was though rational from the institutions' (and its

5 The MITT, the Hungarian chamber of trade, some unions and research organizations were fighting the rollback strategy literally until the very last days.
6 The first edition dates back to 1984, the second edition to 1990.

leaders') point of view, but much less efficient from the macro (systemic) perspective.

A related issue is how large public companies adjusted to the market environment, or, as it is often postulated, how do they shape the fundamental qualities of the market order according to their own tastes. While quite a few theoretical papers were written up to show how it should be, it is, in the end, an empirical issue. Now it seems, that enterprise size matters more than the form of ownership in shaping the pattern of adjustment, except for strategic foreign owners, who can and actually do, act as textbook principals against their agents (managers). In the latter cases rearrangement and restructuring of assets, organization and product lines is normalcy. In the 'national' large corporate sector the interesting finding is that in efficiency terms there is no across-the-board - difference between the public and private sector companies in Poland (van Wijnbergen / Pinto 1995) and Hungary (Major 1995). Whereas peculiarities of the Czech corporate governance make it hard to establish what is actually private, what is public, and what is in-between (non state) sector, later overviews (Kolodko / Nuti 1997) emphasize the sustainingly improved performance of Polish public companies in a competitive environment. In case of Hungary one by one analysis of the once notoriously powerful 49 large public companies (Voszka 1997) testify of a variety of adjustment methods, with those wanting to continue the bargaining with the authorities faring worse than average. As a rule, a combination of slimming and new acquisitions, sometimes also of public money, were the keys to survival. But the previous phase, when being a big company equaled to being the state is over, and more normal forms of scale economies in bargaining these? They no longer may define themselves as independent variables against their environment. Liquidations, bankruptcy, acquisitions as well as massive layoffs and the adverse publicity surrounding bailout operations constrain them very heavily in the 1990s. The latter - primarily how the bankruptcy legislation bites - has been varying considerably in the region. A part of the literature accuses the Hungarian policies of having been unnecessarily tough and thereby disruptive. Others consider exits from among large firms as a precondition for market clearing to make sense. But this debate must sound rather familiar to a West European reader.

Though not included in the Copenhagen criteria, the EU has always laid a great emphasis on the good neighborly and compromising attitude among candidate members. This may explain the technically otherwise hardly justified interest in CEFTA as well as Romania's formal joining the Five in May 1997. This has, indeed stimulated more cooperative attitudes in the majority of cases,

7 Large companies, like Chrysler, Creditanstalt, Allitalia or Credit Lyonnais exert certainly more leverage on public finances, than a corner shop. But it is not the same as the intertwining typical of the one-party state.
hrvna, the devaluation of the Romanian lei are all indications that arbitrarily declared exchange rate stability is not a sustainable systemic option (as yet). As Yugoslav and Italian experience recurringly demonstrated, while anchoring may be inevitable in the introductory phase of stabilization, fixed rates survive only if the entirety of macroeconomic fundamentals are right. This means primarily sustaining success in arresting inflation, rather than the other way round (as the slogan of ‘importing credibility’ would imply).

EU countries know it only too well how hard a job it is. Thus it is not realistic to expect Central Europeans to be ready for EMU already at the time (or even during the advent) of their accession, since they will probably not yet be in the position to take advantage of ‘tying one’s hand’. But this should not be seen as a very grave problem when it is probable, that not all incumbent EU countries will make it to the first group of members in the currency union. The arrangement to be elaborated for the ‘ins’ and the partly self-declared ‘outs’ can easily be transferred to the newcomers. This makes suggestions for a phased membership (as e.g. Tichy 1997) fully out of date.

Central Europeans take the Union as a point of orientation, thus a strong, well functioning EU with a stable currency, rather than anything else, what they are for. The survey of their progress made in the various areas covered by the Copenhagen criteria shows: these economies should fit fairly well into an EU that allows for the competition of systems. A graded membership is unrealistic not only because it would only perpetuate currently observable lags and distortions, but also because of the evolution of the acquis over the last decade. Single market arrangements expanded by Maastricht leave little room for the replication of 6-7 years interim periods and the wide use of derogations in the economic sphere, as was the case with Southern enlargements. The history of trade protection is also a history how temporary arrangements solidify and lead to mis-development and maladjustment. Thus a flexible interpretation is needed, still taking over the full acquis is the only realistic way to avoid the greater evil. Paying the price of adjustment is certainly the smaller amount.

And in our survey, as long established methodological procedures are not given up for policy statements, we could not find a single area where the distance of newcomers to incumbents would qualitatively differ from the already available North - South differences within the EU. And it is realistic to expect the Czechs or the Estonians to be more of a problem than the Greeks or the Spaniards? In sum, the phased membership idea is not only a legal nonsense, but also based on impressionistic economics at best.

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8 Messerlin (1997) goes as far as questioning the WTO conformity of this arrangement due to its basically bilateral qualities.

9 Sweden, Britain, probably Denmark will not join in, should the EMU in 1999 really materialize; Greece will also likely to be ‘out’.

10 In the environmental, social and maybe in some other non-economic areas derogations may become feasibility side-conditions.
Having presented the critique of most common fears from the dangers of the 'East' does not imply a rosy picture, free of any problem. The second message of this paper is on what this author perceives as major, though mostly covert or neglected, trouble spots in and for Central Europe,11 should full membership materialize in the medium run. The list presented below is by no means exhaustive. It is conceived under the narrow, self-limiting angle circumscribed in the introductory section, and does not attempt to answer (or cover) all major problems and unresolved tasks of transformation. It is fairly clear that systemic change and world economic adjustment will continue way after accession, further public choices will have to be made, and the entire adjustment of Union economies to the challenge of Asia will have relevant implications for Central Europeans too. But these issues lead beyond the scope of the present paper, devoted to proving the maturity of transforming countries for EU membership, and problems therein.

1. One of the structural weaknesses in transformation has been the inadequacy development of agricultural market institutions and its infrastructure. As a recent survey article (Fertő 1997) has convincingly demonstrated, even in Hungary, where the farm sector used to be relatively marketized under the socialist period, very little of the institutions typical of contemporary West European agriculture emerged or were organized. In reality, traditional pre-occupation with quantitative and income redistributory targets prevails. Hungary’s hopeless debate with its WTO partners on agricultural export subsidies in 1996/97 is possibly the best direct indication of how little all agents, active in this area, have understood the logic of managed markets. This may, in turn, become the source of several undesirable developments:

- The lure of simply copying EU CAP arrangements in the name of harmonization will increase. Not only the forthcoming EU reforms make this uninspiring, but simple economic calculation and realities of international food markets, saddled with chronic overproduction, render this a less than desirable option;
- lack of regulation may (re)create wide fluctuations that are (has been) typical features of early capitalist market order, with the concomitant social and economic costs;
- environmental concerns may simply go under both in the over- and in the underregulated scenario;
- cultural, regional and way-of-life considerations call for measures enhancing the capacity of rural areas to retain their population. This requires de-coupling à la MacSharry, i.e. regional and income support schemes irrespective of farming output performance. This is a serious challenge, both for government administration and interest representation. Inability in managing this task may lead to overinvestment in non-marketable production with simultaneous underinvestment in regional infrastructure and environment-protection. The wrong pattern will be prone to reproduce itself.

2. Financing and organizing regional policies. This area has traditionally been poorly integrated into governmental decision making in Central Europe. In Hungary, municipalities, the Ministry of Interior, the Ministry of Transport, Communication and Water Management, as well as the Ministry of Environment have a responsibility for these. The agricultural department considers these as concurring establishments in its fight for scarce resources. Local municipalities were endowed with far-reaching proprietary rights by the 1989 Constitution, supported by decisions of the Constitutional Court in their favor.13 However, in practice these bodies are able and willing to enforce their rights to a varying degree. The major problem is, that in depressed areas, where more entrepreneurial spirit were required, municipalities, too, are underfunded and idle. Contrary to Scandinavian practice, these mostly lack both the ideas and the administrative capacities needed to tap EU funding. It is quite likely that they will be able to draw only a fraction of those entitlements that would accrue to them under (any) Union arrangements.

The organizational splintering is exacerbated by the survival of the ratchet principle in fiscal planning, both at ministerial and municipal levels. As a consequence all available funds must be spent during the calendar year, therefore no reserves are built. Should external money be forthcoming, the own contribution would be hard to find, as the potential reserve had already been earmarked for a competing claim, safely foreseen by the fiscal planner. Thus waste coexists with shortage, and none can be cured, as known from the command economy period.

Experience with the first year of the public procurement act amply demonstrated, that even central authorities find it hard to cope with the new,

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11 The other side of the same coin, viz. how the EU should (help to) cope with these, could be a subject of a different paper.

12 The dispute ended with a compromise, allowing for the years until 2002 (rather than the original 1997) for phasing out direct export and (non green box) production subsidies in Hungary, in line with the 1994 WTO commitments cf. Népszabadság, 18 July 1997.

13 The decision of 1995 outlawed fiscal decrees aiming at excluding townships from the privatization revenues of the State. In a similar vein, a 1993 decision established municipalities as fully-fledged proprietors, equal to private persons, as owners of flats.

14 The introduction of the Treasury Office only reinforced this feature in public organs.
more transparent and competitive procedures. Municipalities, to a large extent, have an even more risk-shunning and competition-averse tradition. Reliance on external consultancy is sporadic and random. One of the positive contributions of EU accession might be that sufficiently lucrative sums may be targeted, that will already worth the effort needed to ensure their availability. The latter could be a civilizational accomplishment, owing to its spread and intensity alike.

3. Fiscal policy suffers from a number of shortcomings. Its information base is incomplete at best. In case of Hungary there is no consolidated up to date balance sheet of state property. Double accounting of external debt was discontinued only from 1997. The expenditure side is predetermined by political overcommitments, implicit debts (as on the pension system) and inherited organizational setup. Functionality, cost-control, and personal responsibility for misuses of funds (overspending or arbitrary reallocation) is nonexistent. Reference to the fact that many other countries suffer from the same ills does not cure it. On the revenue side the textbook case (as counter-indication) of high nominal tax rates coupled with their lax administration and many exemptions proliferate, despite tax reforms, having lead to a considerable growth of implicit tax burdens (Newbery 1996). Modest or no improvements on these structural affairs may discount the value of some of the impressive cuts in public spending ratios in Central Europe. EU countries are the best examples, how unrefomed fiscal structures recreate the debt problem, owing to the rigidity of the expenditure side.

This might pose a difficulty not so much in terms of the Maastricht debt criterion (which may require some further efforts from Polish and Hungarian fiscal authorities, though currently do not look unattainable). Pension and health care reforms are likely to make previously implicit debts explicit. This will create a problem, should reforms improving both the revenue and the expenditure side, not be forthcoming. Lowering rates and severing administration is certainly the way-out, though that is also easier said than done.

4. Sustainability and stability of economic policies may or may not be forthcoming. One of the pleasant surprises in the 1989-97 period in the three most likely future EU members of Poland, the Czech Republic and Hungary has been the truly remarkable stability of the overall policy line among, and above, the frequent twists and turns of their daily politics. The explanation for this is different by the country. Whereas in the Czech case virtually the same

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5. As long as the previous points caution against overoptimism on the inflation front, exchange rate stability cannot, and indeed, should not, be declared flat. All the less so as trade balances and current accounts of the candidate countries do not seem to be strong enough to cope with any amount of real effective appreciation of their currency. This is not to imply any
leniency in exchange rate policies. However, normative theoretical statements should, at the policymaking level, be reconciled with realistic target setting. Introducing temporary import surcharges (as in Hungary in 1993) or temporary import deposits (as in the Czech Republic in 1997) or the continued use of quotas (as in Poland in 1996) in order to avoid devaluation are clearly more discriminating, distorting, and also less adequate alternatives. A gradually decreasing crawling peg seems to be the relatively least harmful bridging solution, until improvement in the fundamentals allow for the rate of exchange to stabilize. This is unlikely to be an abrupt jump. On the contrary: arbitrary fixing may only lead to discretionary devaluations, with the resultant loss of credibility for the entirety of policy. Stressing the relevance of EMU, as part and parcel of the acquis, meanwhile may play an important educational role in cautioning Central Europeans against leniency on the exchange rate and inflation fronts. The perspective of Union membership, on the other hand, may provide precisely that impetus which is needed to overcome reform fatigue and to steer politicians to strive for more in their fight for financial rigor amidst recurring pressures for new and new spending sprees. Meanwhile the error of mixing up ends and means in thriving for exchange rate stability should also be avoided, as premature declarations of victory (over inflation or in having mastered privatization and restructuring tasks) may only backfire.

6. Emphasizing the social dimension of Europe, widespread malpractices in incumbent members on their labor markets may easily trigger attempts at the legislative level to emulate in Central Europe those arrangements that make EU labor markets so rigid. Polish and Slovak experience in the 90s already indicate: high growth rates of GDP alone fall short of taking care of massive (double digit) rates of unemployment. Labor legislation is easy to pass, especially when wide coalition parties (Volksparteien) govern, but by the same token the deregulation of the same area is next to impossible. The only prudent choice Central Europeans may have is to avoid overregulation and lay emphasis on forms that enhance employment, like small and medium size business, seasonal and part-time work, subcontracting and working at home (a Japanese practice much supported by the spread of personal computers). Lowering the social security burden of employers may also be indispensable if more jobs are to be created. Limitations to fire are also limitations to hire. The more widespread is the use of tripartite/corporatist practices in setting wages across the board, the smaller is the chance of ‘outs’ ever to get in, further the likelihood of structural conservatism also increases. The slogan of social Europe, coupled by one-sided emphasis on unification of everything, with reference to the leveling the playing field argument, might be particularly detrimental for the less developed Central Europeans. While they have no leverage over shaping the acquis, they do have a leeway in organizing their own arrangements, where marginal productivity of labor considerations may act in an efficiency-enhancing manner. Anchoring social rights in the Constitution, as it happened in Poland in 1997, and has been attempted in Hungary in 1995-97, can only lead to claims that no government can come up for, but it can also trigger unsustainable and anti-competitive legislation.

Consolidation of public finances has been practiced by moving along the lines of smaller resistance. Cultural and educational establishments have significantly smaller bargaining power than, say, miners, air traffic controllers, or peasants. This has lead to wearing down and bleeding out of universities but also much of the secondary education. Private supply of educational services focus on ‘how to do’ courses, post-secondary degrees and immediately useful market knowledge. Though necessary, but hardly sufficient to cope with the numbers of school-leavers, not being qualified enough to join in the fight for jobs, where language skills or computer knowledge is required. These hundreds of thousand are though unlikely to flood Ireland or Portugal as job-seekers, but their presence may create a social strain. Poorly trained intellectuels, not prepared for the competitive conditions may only multiply this problem. In sum, a large segment of (partly) involuntary rent-seeking population (on the Spanish model) may create a lasting problem both for the new entrants and the Union, and not only in terms of financing. The tighter labor market legislation knit in the name of social justice, the less likely these people could ever be integrated into their respective societies, partly for their inadequate cultural conditioning.

7. Qualifications in the state administration may, though well be relatively high, but its nature and pattern is often incongruous to what the multi-nationalism of the Union would presuppose. In Hungary, for instance, it is very rare to find anybody speaking and writing with a good command of both French and English. In many departments technical and (mostly out of date or narrowly national) legal or economic knowledge is made up by experience, whose relevance is often questionable under the new conditions. Multinational lobbying is a by and large unknown phenomenon. EU affairs are often seen as a prerogative of the Ministry of Foreign Affairs, and the initiative as well as the expertise to enter foreign markets is often missing. The administrative capacity to manage (rather than just to translate and promulgate) Community legislation is severely limited, and may prove to be one of the narrowest bottlenecks for integrating Central Europeans into the EU. The more seriously is the idea of subsidiarity taken, the graver will be the traditional lagging of municipal administrations behind their metropolitan counterparts. In a way it is surprising how little substantial progress is made in these areas despite the proliferation of courses on and more travels to Brussels.

17 This is not necessarily the case, as Scandinavian unions were instrumental in mastering some of the sectoral crises in the 70s and 80s.
8. A realistic cost-assessment of enlargement is non-available. Whereas cost-estimates on the Western side are numerous, and the related number-gazing has developed into a rewarding and popular business, comparable efforts on the Eastern side are not yet known. This is explicable on two grounds.

As not even the shape of post-2000 EU emerged, it is next to impossible to make even the first run of a serious and credible cost/benefit calculation. Individual experiments made in Hungary all employ a 1992 or 1994 ceteris paribus assumption, especially as far as procedures and entitlements are concerned. The only thing which is sure at the time of writing is that both are likely to change. In one leakage the share of citizens enjoying support from structural funds should decrease from 51 to 35 p.c. of total EU population, moreover this amount should suffice to satisfy old members and new entrants as well (Wulf-Mathies 1997). CAP entitlements are likely to be restructured so as to focus support on small establishments on remote areas, irrespective of production levels, while previously supported medium and large farms, producing standard products (and oversupplies) are likely to lose all or nearly all subsidies related to output (Die Welt, 10 July 1997). If both plans materialize, even only in part, the calculation based on ceteris paribus assumptions may turn out to be totally irrelevant.

A first consolidated assessment of total costs put it in the range of 10 percent(!) of Hungarian GDP the cumulated outlays needed additionally over and above the 1997/98 levels earmarked in the Hungarian budget (Kádár 1997). This estimate, produced by the chairman of the budget committee of the Hungarian legislature, may be seen as an upper limit in a pessimistic scenario, where the shortfall of customs revenues is not made up for more intakes from indirect taxes (due to the expansion of economic activity), further profit repatriations jump from the current 100-150 mn dollars p.a. to 1.5 bn dollars, i.e. ten times. Furthermore costs of NATO expansion are put at maximalist levels of modernizing armaments, but without reliance on possible aid shipments. All in all, as these examples show, different assumptions may produce wide variations in actual numbers. Moreover experience teaches that such occasions allow for major clashes of lobbying interest. Each department or area may feel: it is time to make up for all it lost in the previous decade. Modernizing the entire Hungarian air defense system, or recultivating all industrially polluted areas, may equally be put on the agenda. Depending on the outcomes of these insights the bill may even exceed that derived from technical considerations voiced above.

But in the end of the day the problem here is that Central Europeans have currently more unknowns than equations, thus the solution can just be a guessestimate. Should an equal number of equations emerge, then the policy task will not have been mastered yet. Namely that sizable reserves for mastering previously nonexistent tasks have to be built into an overstretched budget, already saddled with the task of major future (additional) expenditure cuts. Whoever is in government, such a technical must be close to a political impossibility. Thus even if costs can be realistically assessed, the raising the funds for their coverage will hardly be a trivial job, especially if disinflation has to accelerate meanwhile.

9. Following the Amsterdam Treaty of October 1997 the implementation of Schengen Agreement is part and parcel of the acquis. This problem is particularly serious for Hungary, although the financial side of instituting and administering efficient common border controls will surely be a burden for Poland as well. Hungary is not an island, and her neighbors who will unlikely to be EU members in the future are neither Norway nor Switzerland. Hungary has a strong interest in retaining permeable borders, meanwhile has an equally strong stake to be part of the common home affairs and justice arrangements, and all measures fighting terrorism and organized crime. Hungary and Poland received repeated calls (but no support) to ward off drug trafficking and trade with people. Whereas the commonality of interests would justify major financial contributions of EU incumbents to fight organized crime, it seems unlikely that the required amounts will actually be transferred. A poor physical infrastructure may dilute much of the substance of Schengen, while possibly nobody wishes to re-erect the Berlin Wall on the green borders in the hearth of Europe in the name of fighting the spillover of Mafia-capitalism.

10. Last but not at all least the quality of regulation should be mentioned. As an Austro-Soviet heritage, detailed and frequently changing rules with many loopholes and wide room for bureaucratic interpretation for individual cases is prevalent in all the three countries. Therefore regulation in economic theory, but also in public debates, is rarely seen as setting rules for everybody and for ‘eternity’. Most laws address specific situations and issues, thus they cannot be kept stable in a changing world. Legal instruments are often instrumentalized to settle income redistributory conflicts, restrain market access, or sustain (self-employ) bureaucratic organs, or worse, serve prime political objectives of a given election cycle. This is coupled with an underfinanced and under-equipped judiciary, which can be politically leveraged. Judges try to keep out of truly contestable issues, be that political or business conflict. Procedures allow for cases to be settled in 3-4 years. A large number of rules coexist with their lax implementation. In public perceptions legal fetishism and disregard for prescriptions and proscriptions is nearly as widespread as in Southern Europe.

Rule of law and law-abiding behavior can certainly evolve, not, however be declared. Therefore it is likely that the sanctions and enforcement mechanisms of the Union, as well as the experience in regular business relations will help enhancing the observance/implementation of regulation. This is certainly a call to be less perfectionist with issuing new EU regulations. But even under the best of circumstances, a long interim period of trials and errors in applying
legal discipline and the rule of contracts will be required. Public perceptions of the role of law as well as administrative habits may finally change, but only slowly. This finding, that could be observed also by Southern enlargement, will be important in shaping realistic expectations on the Union side vis-à-vis the new members.

E. Outlook

This paper consists of two contradictory parts. The first part is an attempt to prove: those obstacles to accession that are most widely discussed in the literature are either based on questionable, politically biased interpretation of economics, or underestimate progress that has already been accomplished in the frontrunning transforming countries. In the second part ten less spectacular, though deeper rooted problems are listed to show some of the real trouble that is likely to come only after accession. The solution to the paradox is involvement and integration, not money. If there is a perspective, those immediate tasks that are faced by the policymaking level are relatively easy to manage. Those part of the problems that relate to habits, inherited stocks and social intangibles may only change in an evolutionary manner, i.e. slowly. In fact these, both sides may well prepare for the post-accession period, when quite a few of the inherited problems will remain with us. There is still a room for optimism: involvement and integration does not equal to pouring money into a bottomless barrel, nor to hectic governmental activism. On the contrary: it is about setting free the mechanisms of self-regulation, by which tens of thousands of agents adopt new ways and welfare improves. When Spain, Portugal or Ireland joined in, they faced similar problems. And even Greece’s 4.9 percent inflation in 1997 not only may, but actually does indicate a major change in those deep-rooted habits, which social scientists sometimes consider as constant. Central Europe has already mastered some momentous tasks, like reorientation, liberalization and privatization. Integration will conclude the second phase of transformation, which is, to a large degree, ahead of us. But the tasks yet to be solved should be tackled anyway. Involvement may provide precisely that impetus, which is needed for the policies to take effect. And the remaining task is momentous, just because it is non-trivial and it is not well perceived by the transforming societies themselves either.

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Korreferat zum Referat von László Csaba

Von Jiří Kosta, Frankfurt am Main


Der Korreferent schließt sich der positiven Aussage über die „EU-Reife“ der Dreiprinzipiell an, sieht sich jedoch bemüht, dieses Fazit zu ergänzen. Bei der aktualisierten Auslegung von Kopenhagen ist zu dem grundsätzlichen „Ja“ ein nicht zu vernachlässigendes „Aber“ hinzuzufügen. Auch die drei Spitzen-