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Foundations and Framework on Enlargement

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The eastward enlargement of the European integration has been on the agenda for more than a decade by now. If we consider that the longest accession period, the British, lasted twelve years, while the target date of 2002 has had to be abandoned even by the most ambitious candidate countries, it is obvious that the process is extremely protracted.. On the one hand since the Luxembourg Council of December 1997 at latest, the fact of enlargement seems to have become a settled issue in theory. Meanwhile practical modalities of this process proved to be harder to elaborate than most analysts would have supposed. For the time being official optimism puts 2003-2004, expert opinion estimates 2005-2006 as the earliest point of time when the *first* formerly communist country may actually join the EU.

If we take the long term view (Table 1) we can establish a remarkable reorientation of trade relations from east to west. The share of developed market economies in the total exports of central and eastern European countries has climbed from 35.7 per cent in 1980 to 49.5 per cent a decade later, and further increased to 75.8 per cent by 1999, whereas the share of the former Soviet Union has declined from 27.1 per cent in 1980 to 22.3 per cent a decade later and 4.8 per cent by 1999. In other words, the dependence on Russian markets and the structure determining role of the former colonial core has given way to more normal patterns of trade, if gravity models or experience with countries similar level of development are indicative of what "normalcy" is. In many ways, widespread doubts in the feasibility of such reorientation has dominated the trade and transition policy debates a decade ago, which have by and large subdued by now. It is worth noting that the doubling of eastern European exports in the 1990s, from 61.7 to 118.2 bn dollars stands in sharp contrast to the stagnation of the 1980s, when total sales of the region hardly grew from 56.4 to 61.7 bn dollars (ECE, 2000, p.234).

On the import side such reorientation was often considered next to impossible, owing to the infrastructural and habitual dependence on traditional raw material and energy supplies from Russia. However, as we can establish from Table 1, the declining importance of Russia as a trade partner had been setting on already in the 1980s, when the import share of the then dominant power declined from 26.8 to 17.9 per cent, with the trend accelerating in the 1990s and leaving Russia with 7.8 per cent in the total suppliers to central European and eastern European states. The long term view shows that there has been no abrupt trade policy shifts, attributable to transition and the related cooling down of political climate. Rather it is the *secular trade pattern* which explains how radical transition policies including that of trade re-orientation have been imposed upon the countries of the region.

Table 1 Foreign trade of eastern Europe by direction 1980-99 (shares in total trade, per cent)

	1980	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Eastern Europe, to and from														
Exports														
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
ECE transition economies	48.5	50.2	46.5	44.4	38.1	28.5	23.0	28.2	26.3	25.8	26.1	26.1	22.5	18.6
Former Soviet Union	27.1	29.7	27.2	25.5	22.3	17.9	12.4	9.8	9.0	8.9	9.4	10.3	7.5	4.8
Eastern Europe	21.4	20.5	19.3	18.9	15.8	10.7	10.7	18.5	17.4	16.9	16.7	15.8	15.0	13.8
Developed market economies	35.7	35.2	38.7	42.6	49.5	59.8	63.0	58.0	62.5	64.5	65.0	66.4	71.6	75.8
Developing economies	15.8	14.6	14.8	13.0	12.4	11.7	14.0	13.8	11.2	9.7	8.9	7.5	5.9	5.6
Imports														
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
ECE transition economies	42.0	45.6	40.5	36.4	26.6	25.5	24.7	29.3	26.1	25.3	23.8	22.1	19.3	18.1
Former Soviet Union	26.8	30.7	26.3	23.5	18.3	20.2	17.9	16.5	14.1	13.2	12.7	11.2	8.7	7.8
Eastern Europe	18.8	20.5	19.6	18.7	14.3	8.1	6.8	12.8	12.0	12.1	11.1	10.9	10.6	10.2
Developed market economies	38.7	36.1	41.1	44.0	53.3	58.3	64.4	61.5	65.0	65.8	66.6	68.1	70.9	72.1
Developing economies	19.3	18.3	18.4	19.5	20.1	16.1	10.9	9.2	9.0	8.9	9.6	9.8	9.8	9.8
Former Soviet Union/Russian Federation, to and from														
Exports														
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
ECE transition economies	34.5	33.5	29.4	26.6	21.8	25.9	22.3	18.1	15.1	16.8	18.2	19.5	18.1	17.4
Eastern Europe	34.5	33.5	29.4	26.6	21.8	25.9	20.7	16.8	11.7	13.2	14.3	14.9	14.2	13.2
Developed market economies	42.2	35.3	38.9	41.8	49.5	56.5	57.9	59.7	66.6	60.6	58.1	58.6	60.0	58.0
Developing economies	23.3	31.2	31.7	31.6	28.7	17.6	19.9	22.2	18.3	22.6	23.8	21.9	21.9	24.6
Imports														
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
ECE transition economies	31.5	38.2	32.4	27.6	24.7	26.0	15.9	10.6	14.1	15.5	12.6	13.7	11.9	9.6
Eastern Europe	31.5	38.2	32.4	27.6	24.7	26.0	15.0	10.0	11.7	12.4	10.6	11.1	9.8	8.3
Developed market economies	46.4	40.7	46.3	50.1	52.9	58.1	62.4	60.6	70.3	69.5	67.8	68.3	68.2	68.0
Developing economies	22.1	21.1	21.3	22.3	22.4	15.9	21.7	28.8	15.6	15.0	19.6	18.0	19.9	22.4

Source : ECE (2000), p.237

It is remarkable, and supportive of the above reading of facts, if we consider that developed market economies have already acquired 64.4 per cent in the total *imports* of transition countries *by 1990*, up from a mere 38.7 per cent in 1980. In the following decade the share of these imports has hardly grown, up to 72.1 per cent. It is remarkable, how limited the role of developing economies has remained for the region, with a marked process of marginalisation shaping the entire 20 years of analysis. A similar pattern of reorientation is observable for the countries of the former Soviet Union with *developing countries substituting the lost Comecon markets,* as outlets of less competitive produce as well as suppliers of less demanding items for domestic consumption. If we consider the absolute magnitude of these imports we see a stagnation in the 1980s, meaning a slight decline from 65.4 to 63.4 bn dollars between 1980 and 1990 as a result of overall import restricting policies. With the easing up of these, trade liberalisation produced a marked surge in imports, from 63.4 to 156 bn dollars between 1990 and 1999 (ECE, 2000, p.235). This shows the growing importance of the region as a market as well the *insufficient ability to cover the growing demand for foreign goods with sufficient currency intakes* - a problem that may become particularly important for countries wishing to approach *EU* and by implication EMU.

If we supplement data on trade flows with data on *financial flows* we find an explosive growth of foreign direct investment, from a mere 479 mn dollars in 1990 to 17.2 bn by 1999 (ECE, 2000, p.240). This is due to the low starting level and reflects the gradual *reintegration* of the transition economies in the international intercorporate division of labour. True, over three fourth of this increased inflows are recoreded by the three central European countries, Poland, the Czech Republic and Hungary, which is indicative of other countries' seriously lagging behind in this process. But those who did manage to invite significant foreign participation in their national economies, primarily the three plus Estonia and Azerbaijan, have been taking part in the process of microeconomic globalisation.

To put it differently, what we observe in the postcommunist transition is, in terms of international integration, a rather textbook-like process, where it is first the *microfoundations of integration* which have been lain. Later, institutional and macropolitical changes complement and complete what has already been evolving. To put it yet differently, the three central European frontrunners and Estonia, but to a smaller extent Slovenia and Slovakia as well, have already made significant progress in their integration in the European division of labour. Regional patterns of trade have been changed together with ownership patterns and interfirm relations. If a decade ago the typical agent of economic activity has been a large national state owned industrial enterprise, the *representative agent today* is a large, partly or wholly multinationally owned servicing or banking unit, whose national and organisational boundaries have become equally fluid (Kocsis, É. 2000). In practical terms thus the *integration to the European economic space has become an accomplished fact* at the trade, financial, organisational and ownership levels alike. Among the several components of this process financial sector opening deserves special attention. Unlike in the previous southern enlargement, when financial sector opening followed EC membership by several years, frontrunner countries of central Europe have already opened up their financial sectors, partly in their acceeding to OECD, partly following the deliberations of the Europe Agreements. Therefore it is unlikely that eventual EU membership will or could constitute an external shock of any sort, since both the favourable and the unfavourable components of financial sector liberalisation have already been internalised by those agents investing in the region, both as acquisitions and portfolio investments (Buch, 1999).

Thus even a rudimentaly overview of basic facts invites a splitting of the issue of eastern enlargement into two. First: why has the EU been so *slow* in accomodating the frontrunners? Second: why has been, until recently, the EU been void of a strategy of *what to do with the lagging behind* and with the non-candidates?

At the present stage two preliminary answers can be given. The EU has been slow since its reforms of its internal decisionmaking structure has been slow. And as the Corfu Council of 1994 has already established, the current arrangements, based on a large degree of informalism of the early period, have been overstretched by the growing number of member-states as well as by their increasing diversity. In order to be able to accomodate even more members and even more diversity, the EU itself needs to be restructured.

On the second question the answer is more confusing. First, the EU has spent most of the 1990s on adopting itself to the novelties that resulted from the decisions between 1986-91. Domestic and intra-EU items dominated the agenda and strategic debates were often non-existing even among the élites, thus the truly historic dimensions of rearrangements what an enlargement implies have not even been considered (Weidenfeld, 2000, p.1). As a result the EU, especially at the official policymaking level, adopted a *unilateralist* club approach, confronting candidates with a take it or leave it stance, denying of what leading experts (Wallace, 2000, p.491) consider as the obvious, that any enlargement involves *mutual* adjustment, new items on the agenda and restructuring previous priorities, including spending priorities.

We may add a third factor, that has become particularly visible in the three Balkan wars of the 1990s. The *Ostpolitik* tended to be built on postulates rather than experiences, and actions followed the logic of domestic policies of major powers, not the observable processes with in the region (Daalder and Froman, 1999. esp. pp.110 and 1 12).[1] This implied the overestimation of democratic and marketising transformation and its stability, both in the post-Soviet area and on the Balkans. Therefore the split between expectations and realities have been escalating, triggering new twists, turns and improvisations, that have *not* been adding up to anything like a *consistent strategy*.

In the following we shall first address the stage and progress of reforms of various EU arrangements, then we address the challenge of the single currency. Following this we turn to the new horizons of the EU *Ostpolitik* as it evolved after the Helsinki Council of December, 1999). Then we report on some experiences in the accession negotiations, and conclude.

The present state and progress of intra-EU reform

The need to retailor existing intra-EU arrangements has *not* emerged primarily as a consequence of policy decisions in favour of enlargement. On the contrary, already back in the 1980s when stagnation of the previous two decades could be overcome, expert opinion was close to consensus on the need to *restructure at least three core areas:* decisionmaking, the common agricultural policy/CAP, and the way structural funds operate. The northern enlargement of 1995 has significantly increased the diversity among member-states and new items emerged on the community agenda, such as night transportation or the support of sparcely populated areas. The prospect of accession by a large number of small and less developed countries has already foreshadowed an external shock to the status-quo oriented practices of the EU. Therefore inherited and recurringly postponed reform measures have gathered more momentum.

It is worth reiterating: changes in the three core areas listed above are neccesitated basically by *efficiency* considerations, as well as by the interests of the taxpaying *majority* in *current/incumbent EU.* The very fact that Council sessions where deliberations with financial implications had to be taken, regularly extend into the morning hours reflect the limits of decisionmaking procedures. The fact that in the internet age half of the community spending still goes to the primary sector of agriculture is an obvious macroeconomic paradox. Last but not least the low efficiency of projects created via the structural funds, like the notoriously underutilised Bari Airport or the similarly inefficient Lyon TGV/Airport complex, already foreshadow the need to change with or without enlargement. Global partners of the EU, from multinational corporations to underdeveloped countries are decreasingly willing to put up with the consequences of a fortress Europe.(2)

These inherent/internal pressures for change have only been *reinforced* by the political prospect of an eastern enlargement. Meanwhile at least some reforms of this type are inevitable *preconditions* for an affordable enlargement. One of the few consensus points among member-states is their support for the deliberations of the Edinburgh Council of 1992, having capped community spending to 1.27 percentage points of national GDP. This is not an economic, but a political exigiency that acts as a truly *hard budget constraint on any enlargement* project. More lavish alternatives have though been repeatedly advanced in the more theoretical literature, calling for more generosity in order to promote financing the catchup process. Whatever is the merit of these considerations, the political feasibility of their implementation is next to nil. This has clearly been indicated by the horsetrading procedings the Berlin Council. The Agenda 2000, often concieved by the candidate countries as a primarily accession document has been, for the incumbents from the very outset, primarily a financial guideline. In the policymaking process, reflecting the lack of visions even among élite decisionmaking groups and think-tanks (Weidenfeld, 2000, p.1.) the deeply anti-integrationist stance of Baroness Thatcher - 'I want my money back' - has prevailed over broader security and strategic considerations. While the latter would have called - and still call - for a broader view of the enlargement issue, embedding it in overall post-cold-war arrangements, community policies have entered a different road. They tended to deny what strategic analyst consider as trivial (Wallace, 2000, p.491) i.e. the impossibility and inadmissability of a club-like behaviour, confronting new entrants with a 'take it or leave it' approach. As on previous occassions of enlargement even the larger, stronger incumbent community needs to adapt itself, if for no other reasons because of the *specific concerns* of the newcomers and the ensuing growing *heterogenity.* If one thinks about fisheries providing for over 40 per cent of the acquis, or the newly emerged concern over night transportation and the noise created by it, the previous examples are telling. Confronted with a prospect of enlarging with poorer countries in great numbers, the EU has been lead by the supreme fear of watering down of its accomplishments. Therefore in all of the documents paving the way to eventual enlargement the defence of the already accomplished level and *modus operandi* of integrational arrangement enjoyed a clear priority over the novelty of the challenge posed by postcommunist transition.

In the Europe Agreements therefore the EU refrained from sharing the objective of eventual membership. In the Copenhagen Council decisions of June 1993 it did accept though the objective, without however offering a deadline, or a set of *mutually* binding criteria for accession in a later stage. It is worth underlining that the far the most important among the Copenhagen accession criteria has been the fourth, one making eventual enlargement conditional upon the ability of the Union itself to take upon new members on board. Thereby the most important criterion is one *not under the control of candidates.*

a) *Internal restructuring of institutions.* It is hardly by chance that when the Madrid Council entrusted the Commission to elaborate modalities of a potential enlargement in 1995 it also convened the first Intergovernmental Conference, IGC. The Turin meeting of 18 months has been extremely useful in so far as offering an official opportunity to discuss in detail, and from the point of view of political feasibility, each and every of the major reform propositions elaborated in preceding decades in the literature on integration.

The outcome has been a sobering one. While technical solution to most of the contentuous issues could be solved, the political will to implement them has been missing. For instance the long debated issue of double majority, in which not only the majority of Council votes, but also the support of the majority of Community population need to be ensured in EU decisions has foundered on fears of some member states of being overrun, and by the smaller states' safeguarding their prerogatives, stemming from the well-known disparity that one Luxemburgian vote in the Council represents 200 thousand citizens, while one German vote 8 mn.

The outcome has been formalised in the Amsterdam Treaty. In a typical feature the Treaty could not actually be signed in the city lending its name to it, but in a separate council session in the Hague five months later. The treaty (in detail c.f Csaba, 1998) is a streamlined version of previously available Community legislation, rather than a watershed hoped for by many. From the point of view of accession it has certainly not brought about the much required flexibility by which 25 or 30 members could co-operate. It has *not* created an *algorithm* whereby the accession by a large number of new states could be instrumentally managed. It has though capped the number of Commissioners in 20 and the MPs of European Parliament in 700, but not procedures or political compromises emerged that would have spelled out the way of implementation.

Moreover, the Treaty even *strengthened* the unilateralist club-like approach to the *acquis* by incorporating the Emu and the Schengen Accords, i.e. two areas where several incumbents still have optouts. By so doing it practically turned these accomplishments *non-negotiable* for the candidate countries.

Thereby the Amsterdam Treaty *enhanced* the entry barriers for new entrants compelling them to deliver more than incumbents do. It is hardly by chance that when the policy changes in the Union, strongly influenced by the twists and turns in Kosovo, and more particularly the Russian conquest of Pristina, triggered a new strategy on the East. In Cologne in June 1999, decision has been made to re-convene a new IGC to settle all the issues that were left open in Amsterdam. The mandate of the IGC, formulated in Helsinki half a year later is clearly constrained to the "leftovers of Amsterdam", i.e. focuses on topics directly related to enlargement. The similar consideration re-emerges in the *obligatory deadline* set by policy-makers for experts, i.e. that they had to report their results to the Council session closing the French Presidency in December 2000 in Nice. National standpoints have not been substantially modified in recent years. Moreover the Parliament in its official capacity has re-submitted far reaching reform proposals, which would enhance its prerogatives in nominating the President of the Commission (while the Council could only propose him), set up a constitution for the EU, enhance the foreign policy role of the Commission, and extend the prerogatives of the European Parliament to such areas as immigration, farming, fisheries, while precluding any single state from vetoing common measures on its own (Leinen, 2000, p.75 and pp.77-78). This has already foreshadowed the stalemate that actually emerged in Nice (more on no.1 in Csaba, 2004).

In the meantime several twists and turns of current politics highlighted the limits of an overgenerous transfer of decisionmaking competences to community organs. The embargo on the government of Austria may well have had its merits[(3)] owing to the pronouncements of Freedom Party leaders in the election campaign, however it lacked legal foundations in the *acquis communautaire*. The much too quick decision to set up the combat batallion of the EU in Helsinki, despite misgivings by neutral members, foreshadowed dangers of small countries' being rolled over. The ongoing controversy over witholding tax is yet another issue over wich the limits of governmental curiosity i.e. an old constitutional issue has come to the fore. The EU decision to take over KFOR peacekeeping troops in Kosovo raised legitimate concerns over how far majority decisions could go in deciding over life and death of citizens of a country (all EU nations employ conscripts except for Britain). In sum, *majority rule* is a good idea in abstract terms, but is a tough thing when it comes down to business. Therefore in theory everybody is in favour, *in practice there is no sign of member countries' willingness to confer their sovereignity to community bodies.*

This finding is reflected in the ongoing sceptical reporting over the IGC and its working in the international quality press, reinforced by open statements by members of the Commission on the need to convence yet another IGC for 2004 or 2005 to settle those issues, which will be hardly overcome by the original deadline. This may have important ramifications. First, such initiatives as the adoption of the EU Charter of Human Rights or the further streamlining the EU Treaty may have their merits on their own, but were unlikely to deliver those flexibilities that have been hoped for at the launching of the new IGC. Second, the EU proved unable to undergo those major changes that would enable it to take up a large number of new candidates on board. Thus incrementalism is likely to continue to dominate over grand designs of various sorts. Enlargement is thus possible *only in waves*, where the absorption capacity of the EU is only slowly growing. On the other hand, this option may allow for the first postcommunist members to have a say in reshaping intra-EU arrangements by the time of the conclusion of the next IGC in 2004.

b) *CAP reforms*. These are triggered basically by two concerns: by the eroding EU position in *international trade talks* and by the pressure of the *Nordic member states* for radical re-tailoring of postwar arrrangements, allowing for self-sufficiency. There had been a fairly straightforward relationship between the MacSharry reforms, introduced in 1992, and the evolving compromise on liberalising agricultural trade in the Uruguay Round.

The MacSharry reforms, continued and radicalised under Commissioner Fischler aimed at *de-coupling income from output*, decreased supports for production and exports, thereby contributed to the gradual easing of accounting for two thirds of CAP transfers. This is all the more paradoxical, since a decade after the 1992 Edinburgh decisions, compensation for price falls of the early 90s do not seem to be the major legitimation for such payments. Also the idea of equal treatment is not respected, as the financial guidelines for 2000-2006 do not envisage coverage for new members.

Therefore Commissioner Fischler called for a new CAP summit for 2002/3 as well as for a *phasing-in policy*, whereby new entrants could gradually qualify for all transfers in seven years (Smith and Koch, 2000). For obvious reasons both sides resisted, still the wayout does not seem to lay anywhere else.

c) Reforms of the *structural funds* will be a high priority for several reasons. First, for the time being all candidate countries except Slovenia would qualify as Target Zone No.1, which would alone explode the community budget. Therefore the Berlin summit agreed that no country will qualify as Target Zone 1 in its entirety any longer, as was the case with east Germany or Ireland before. Structural funds account for over 35 per cent of community spending, thus their targeting is an important issue. In bringing down the Santer Commission the auditing committee delegated by the European Parliament has found several irregularities in this area. Last but not least the intergovernmental horsetrade results in questionable economics in the allocation of funds, so that even Sweden and Finland can report recievables. This is good for domestic policy use, but leaves doubts about the seriousness of those measures that are meant to create the elbow room for the financing of the minimal needs of new entrants.

A basic guideline should be implemented, that emerged long before accession talks, i.e. that *only* measures of *common integrational interest* should receive transfers from joint funds. The trans-European highways probably would qualify, whereas the promotion of Lisbon less so. The clash between internal and external considerations have become particularly manifest during the recurring debates over the sources of funding for the Kosovo presence of the Union, although the money earmarked for Serbia could not have been spent. Funding constraints may undermine the credibility of the officially highly priorised common security and foreign policy of the Union (CFSP).

The single currency - a new entry barrier

One of the most recent accomplishments in European integration has been the introduction of the single currency. Refuting widespread scepticism this unique creature in human history, a common currency not backed by a common state or common fiscal policies, could be introduced with success. Even the tripling of oil prices and the overheating of the US economy could not undermine it, and price stability only most recently has been threatened by inflation, slightly exceeding the two per cent target of the ECB in the 1999-2001 period.

Analysts critical of the ECB voice two fundamental concerns. First, the ECB acts in an ad-hoc/politicised manner, often disregarding those variables on which its medium-run stability policy rests, such as money supply figures and target inflation (von Hagen, 2000). The second criticism is levelled against the fiscal corrections of large member-countries that are insufficient for sustainability, and caution against admitting new members and enhancing thereby heterogenity (Siebert, 2000). Both points imply that accession countries will be very *severe-*

ly judged on their performance in nominal convergence, i.e. on their credibility to join EMU parallely, or not very far, after entering the EU institutional structure.

This development has yet to be properly cognized by policymakers in candidate countries, who customarily reiterate their waiver of meeting Maastricht criteria. In reality the successful introduction of the euro has been built primarily on growing nominal convergence among the member states, whereas levels of developments - or progress in real convergence - remained heterogenous. Portugal, for one, has not been achieving robust rates of growth across the 1990s, meanwhile its fiscal stance consolidated and inflation has come down. Thus it could qualify for Emu *without* first having to catch up to Sweden, Denmark or Luxemburg. Likewise, contrary to most of the therorising on eastward enlargement, the crux of integration maturity is not catchup in terms of development levels. The latter is a serious concern on its own right, but for integration it matters only as long as procedures of allocating structural funds are taken as given. We argued above why it can not be the case any longer.

From the point of view of the acceeding countries the challenge is a double one. First the rationale and modalities of Emu are not subject to debate any longer, but constitute part and parcel of the *acquis*, non-negotiable on various economic and political grounds. Second, with accession date being postponed to the middle of the decade and later, it is legitimate to treat the disinfaltion record of postcommunist countries as a *litmus test of their policy credibility*, as assessed by international capital markets. Fifteen years following the collapse of communism should be sufficient to overcome inherited and transitory disequilibria, or else the committment to Emu can not be taken seriously.

From the point of view of *incumbent* countries the enlargement process is a threat in terms of growing *heterogenity* and diminishing *credibility*. As documented in the above quoted sources in detail, smooth functioning of Emu requires *voluntary compliance* in fiscal and monetary policies, including reforms that make fiscal adjustment sustainable. If it was a tough task even for incumbents, they are right in assuming it to be an even more comprehensive task for candidates.

For the time being *disinflation* has come to a halt in Hungary and Poland. In Hungary annualised inflation stood at 9.5 per cent in the middle or 2000, in case of Poland this number was 11.5 per cent. In the Czech Republic the number was about 4, but economic activity still has not recovered in that country.

Besides, the *fiscal position* in each of the three frontrunners looks *fragile*. In case of Hungary even the planned deficit of 3.9 per cent is anything but ambitious for a country in the phase of 5 per cent growth. In the case of Poland repeated failure to get legislative approval for reform measures allowing for a sustainable fiscal adjustment has prompted the exit of the liberal UW party from the coalition. This makes both early elections probable and the major fiscal corrections before the new government solidifies unlikely. Finally in the Czech Republic skeletons in the cupboard are still being found following three years of adjustment and reforms. The privatisation of large banks, like Komercni Banka and the stormy takeover of Investicni a Postovni Banka, as well as the restructuring of large firms required the injection of enormous public funds, which happened usually through extrabudgetary *allotments and funds. Therefore the consolidated general government* budget is likely to show much *higher imbalances* than publicly reported central budget figures would indicate. Also in both the Czech Republic and Poland much of the restructuring is yet to come, as e.g. the share of industry in total Czech output is over 40 per cent. In sum in all three countries *major efforts are required* to attain a *sustainable* fiscal adjustment needed for EMU maturity. True if it were only for a purpose of external policy, such adjustment were debatable. But these measures are also needed to ensure public sector savings needed for financing sustaining growth in the decade ahead of us (Csaba, 2002).

Herewith we have come to the technically most challenging point of Emu accession, to *exchange rate policy*. Obviously there seems to be a shortcut solution with the acceeding countries unilaterally taking over the euro the same way Ecuador and Salvador swapped unilaterally its currency for the dollar. But contrary to the FED, the ECB has expressed its objections against such a choice, calling it a case of free riding, when candidates wish to enjoy the benefits of a hard currency without making the efforts leading to this. Lacking ECB committent to intervene on behalf of the currencies fixing their rates to the euro enhance the probability of speculative attacks against them. Indeed, due to the asymmetric risks, it is equal to an open invitation to the speculative attack, against which a central bank of a small country can be shown (Keren, 2000) to be basically defenseless, if left on its own. Thus economic as well as political arguments (the need to be co-operative with central agencies of a club we just happen to wish to join) caution *against unilateral* actions.

In the latter case exchange rate policies of the acceeding countries need to mature for Emu membership. From this perspective the frontrunners have made *different options*. In Hungary up until October 2001 a crawling peg functioned, in the Czech Republic inflation targeting delivers an implicit rate, Poland has started to float the zloty in June 2000, while the Estonians apply a currency board. The approaches of the respective central banks therefore are different. The Hungarians wish to maintain the narrow band of fluctuation, i.e. ± 2.25 per cent from central parity instead of the ± 15 per cent in ERM-2, thus follow the Dutch way to euro. The Poles on the other hand are more of the closed economy, where export interests weigh less heavily and antiinflationary rigour may require much tougher interest rate policy, which can be offset by floating. In a way this just reflects the difference of situation, testing competing philosophies (Hofheinz, 2000). The Estonian central bank and government has already announced its intention to jump from currency board to ERM, prompting the ECB to delphic statements on its normative views of exchange rate policies of the candidates. Interestingly and supportive of this restraint is the finding, drawn from comparing exchange rate policies of five small countries during the financial contagion of 1997-99 that remain inconclusive over the vices and virtues of pure exchange rate régimes, and highlighting the relevance of *overall policy environment* and its *credibility* against particular technical options (Darvas and Szapáry, 2000).

This might be an embarassing finding, since the 1992 version of EMU does require two years of participation in ERM-2 prior to joining euro, over and above meeting the convergence criteria. If these conditions were applied very restrictively, there would be a low probability for candidate countries to join in. If for no other reason, because of the ongoing catchup process productivity gains would trigger the well-known Balassa-Samuelson effect. The latter implies that in a catching up country either higher inflation or appreciation of the currency

Table 2 Estimated macroeconomic costs of central Europe's compliance to EU environmental standards

(% of GDP annually)

Country	Scenario 1	Scenario 2b	Scenario 2a	
Year of accession	2005	2005+3	2010	2010+2
Slovenia	1.56	1.07	0.87	0.72
Czech Rep.	1.65	1.05	0.86	0.76
Hungary	2.12-2.90	1.44-1.97	1.17-1.60	0.97-1.39
Poland	1.64-3.17	1.11-2.16	0.90-1.74	0.75-1.45

Note : modified scenarios imply 3 and 2 years of transition periods after full membership

Source : as table 3, p.21.

is likely to follow real convergence. Since ERM-2 implies a *final and irrevocable* fixing of the exchange rate, it is given up as a means of adjustment, and not only as a means of export promotion. Higher inflation rates are unlikely to be tolerable on political grounds, neither is the expediency of such option clear in terms of developmental objectives. Therefore it is likely that graduating transition countries will have to be waived from ERM-2 the same way Italy and Finland were waived and Britain is likely to be waived, should the pound ever join the euro-zone. This takes account of the small open economy nature of central Europeans and *rewards their sustainingly higher rates of growth*, a development certainly welcome in more than one respect. Meanwhile other criteria, such as the evolution of long term interest rate, or the evolution of public debt sufficiently clearly indicate whether or not the candidate country has made the strenous efforts needed to graduate for euro membership(4).

To sum up the argument we may state the following. Membership in the euro-zone offers candidate countries sizable long term developmental benefits in terms of a stable currency, a credible regulatory frame and the resultant ability to attract more capital investment. Entering the zone by definition abolishes the traditional balance of payments constraint on the catching up economy. Thus *joining the euro is a prime economic interest of the candidates*, the longer term view we take on development the more so.

Meanwhile joining the euro zone has its preconditions. Meeting these involves *short and medium term adjustment costs*. While quantifying these is a hopeless exercise (for an assessment of current quantitative estimates and their critique cf. Mortensen and Richter, 2000) it is clear that *sustainable* fiscal adjustment as well as organic and lasting *disinflation*, allowing for the convergence of long term interest rates is not an automatically evolving process. Currently observable macrotrends do indicate and require structural reforms that *rearrange spending priorities and entitlements* for the long run.

This holds all the more so, as current fiscal plans do not as yet realistically assess the *costs of NATO membership*. Nor do they take account of the seriously growing *environmental costs* that are put at 0.7 - 3.2 per cent of annual (!) GDP in the candidate countries (Table 2). As we can observe from Table 3, financial planning for these outlays is in an incumbent stage, where fairly arbitrary assumptions on the role of private capital (in the case of the Czech Republic) or on EU generosity and administrative capabilities of drawing on these (in the case of Hungary) round up the numbers.

Table 3 Proportions of planned investment outlays for environmental clean-up in Central Europe

Country	Private	Public
Slovenia	30	70
Czech Rep.	96	4
Hungary*	27	62
Poland	30-40	60-70

*The remaining 11% of investments are expected to be recovered from EU funds.

Source : Dziegielewska, 2000, p.23.

Nor are the co-financing requirements for EU funds realistically planned in the national budgets. In sum, the *need for deep -rooted reforms*, making non-cosmetic fiscal adjustment of the required magnitude *credible and possible, have become urgent*, particularly for the frontrunner candidate countries.[(5)]

The Ostpolitik of the EU post-Helsinki

The *Ostpolitik* of the EU is comprised of several components, such as policies on Russia and the post-Soviet area, policies on southeast Europe, policies on Turkey and policies on central Europe. It may be legitimate to contend that the relatively *least controversial* part of what major foreign policy strategists (Wallace, 2000; Weidenfeld, 2000) discuss as the need to create a *post cold war architecture* for Europe is just *the enlargement process*, i.e. taking upon board those countries which have advanced the most on their read from command to market economies.

This state of affairs may explain the ambiguous stance the EU has adopted over the last 15 years on its eastern neighbours. In the late eighties the policies of differentiation and rollback has created several important novelties, such as the trade and cooperation agreements (i.e. full diplomatic acknowledgement) signed by Poland and Hungary in 1988, the establishment of the PHARE programme, and last but not least the extension the generalised system of preferences to these countries, allowing for their trade reorientation. From 1990 all eastern European countries outside the CIS recieved this treatment. The signing of the Europe Agreements in 1991-93 though did contain a component of political vision and promise, however they fell short of a clear prospect of membership in EU. Not until the Copenhagen Council of June 1993 did the EU formally share the aspiration of postcommunist countries to join in, even in theory. Meanwhile the Union adopted the accession criteria, out of which the most important is the fourth, as seen above.

In 1995 the NATO decided to invite three countries to become its members. Also in 1995-97 the same three countries acceeded to the OECD. These measures have in many ways been *superimposed* upon intra-EU professional controversies over the security risks any eastward enlargement may entail, as well as over the market maturity achieved by these countries during the years of their economic transformation. If the EU, at that time just highlighting its new priorities called as the first pillar of integration, CFSP, wished to avoid marginalisation in world affairs, it needed to make serious efforts. These were done in the Madrid Council entrusting the Commission to elaborate Agenda 2000, entailing the conditions and procedures for accession.

The Luxembourg Council of December 1997 basically approved the approach of Agenda, taking an economistic stance, i.e. approaching enlargement from the point of *affordability*. Correctly sensing the very moderate progress on internal reforms, the Commission adopted the traditional *incrementalist* EU approach to the new subject, i.e. to enlargement. Last but not least it introduced a new stage, that of *acquis screening*. This process actually preceeded enlargement talks in substance, where the EU as an examiner checked how apt candidates have proved in their taking over the *acquis*. This could delay accession negotiations by two years.

The acquis was split into 31 chapters and negotiations went on one by one. Accession negotiations thus follow parallely, once on the expert level and once on the policy level. The latter often treat sectoral problems in a package, where unlocking deadlock in one area triggers concessions in a non-related area. Meanwhile the Union has retained the right to re-open previously closed chapters, should new information warrant this. In other words, *progress in closing the number of chapters* chapters of negotiations, particularly successfully implemented by the two one-time British colonies of Cyprus and Malta, may be a *misleading indicator for overall progress in negotiations*.

While both acquis screening and negotiations with the first six candidates - Estonia, Poland, Czech Republic, Hungary, Slovenia and Cyprus - proved to be quite protracted, the EU Council has changed its policy line. Under the direct influence of the Kosovo crisis, the Cologne Council of June 1999 adopted a new strategy. Following the initiative of the German Ministry of Foreign Affairs it emphasized two new priorities: the binding in of post Yeltsin Russia in European structures, and the need to support democratic transformation in Turkey.

Though this change of emphasis did not follow from endogenous dynamics of enlargement negotiations, it has certainly created brand new conditions for it. The Composite Paper of the Commission of October 1999 and following it the Helsinki Council decided to invite *all candidate countries* to accession talks, and Turkey too has raised to the rank of a formal candidate.

Whatever we think of the merits of this change, it is clearly a major modification for enlargement talks. According to all impartial analyses, from that of the IMF to the EBRD, from OECD to independent research institutes and rating agencies, *the thirteen candidate countries are currently at very different stages of systemic maturity, economic development and growth path.* Some of them, like Malta and the Baltic states face serious disequilibria, others like Romania and Latvia face growth problems etc. The EU itself has neither progressed with its internal reforms, nor did it spell out the specifics how to cope with this growing diversity. Surveying similar factors has lead *Bilcik* (2000, p.66) to note that the EU has never managed successfully an accession negotiation with more than three countries, nor has it been endowed with *the administrative capacity* to manage such a gargantuan task as handling 13 applicants. This makes further slowdown in negotiations probable. The EU, as members of the Commission repeatedly emphasize, will be forced by this state of affairs to adopt a fairly *uncompromising* stance on its interpretation of the *acquis*, since any concession is likely to be immediately generalised. Lack of funding, even for formally approved foreign policy projects, is likely to further strengthen the *cost-minimising* approach. The more candidates translate -mistakenly - their national interest in *maximising* official entitlements from EU funds, the *higher is the likelihood of negotiation deadlocks due to uncompromis-*

ing stances, even over macroeconomically insignificant magnitudes of money or macroeconomically negligeable sectoral or regional concerns.

What has prompted the EU to change its pragmatic stance of 1997? By and large the Union has been convinced by the United States, carrying the lion's share of the military burden of repeated interventions in southeast Europe, that the region's countries need a *European perspective*. This urge has only been reinforced by the fact that the 1999 Washington session of NATO fell short of inviting new members in the alliance, although Slovenia and Romania have had previously received such semiofficial pledges. Slovakia under the western-looking Dzurinda government also has hoped for it. In a way, the EU was supposed to provide both the money and the perspective for the entire region (Steil and Woodward, 1999). Since money could not be set free, due to the policy constraints described above, and in part, not least to the then very recently stuck new compromise for the financial guidelines for 2000-2006, what the EU could do has been to be more lavish on the prospects.

It is hard to overrate the policy significance of prospective EU membership for recently created or re-instituted democracies. In each and every of the countries of the former second round it is demonstrable, that even with very moderate if any increase in funding governments and pro-western forces in general could profit from the gesture. However it would be hard to overlook the potential repercusions of the growing split between inflated *expectations* and diminishing *possibilities*.

The real issue in the post-Helsinki *Ostpolitik* of the EU is the following. Given that the EU has a secondary if any role to play in setting the strategy on Russia and Turkey in the Atlantic alliance and in G7, *what follow-up steps could operationalise the grand strategy for the entire region?* What can the EU do for southeast Europe, starting with Croatia where the democratic turn of early 2000 has created a new policy environment and responsiveness to EU concerns? What follow-up steps can be made after the cooperation agreement with Macedonia? How can the EU react to the very fragile, and by no means self-sustaining, economic consolidation in Bosnia-Herzegovina? To what extent is the EU able and willing to substitute NATO as the major player in the region without turning the ideology of coexistence into complacency with political and economic crime (on the latter cf. Glenny, 2000)? To what extent are the obviously underestimated true financial needs of reconstruction in the region harmonised with the fairly unreconstructed spending priorities and limited generosity of the EU budget?

For the time being it is easier to formulate questions than answers. Those advocating the grand strategy mostly argue in normative theoretical terms cultivated in post-cold-war IR literature. Those critically reporting over twists and turns of these policies mostly refer to financial constraints derived from quite different postulates and priorities by the same EU bodies.

Some experiences in the 1998-2000 period

If there is anything to be generalised in the wide variety of recent developments, it is the ever more pronounced *divergence* between general *intention* and empirically observable *realities*. While general policies have become ever more forthcoming towards all accession countries echoing theoretical concerns on the inadmissibility of creating new divisions among transforming countries and the need to embed enlargement in an overall *Ostpolitik* (Welfens, 1999, pp.181-2), enlargement talks have been characterised by a fragmentation by the country and by the sector. Especially expert level talks seem to have *slowed down* and even foundered on some cases. For instance the *chapter on farming* can not be considered as opened in substance, as the EU has formulated just a series of questions instead of presenting its own policy perspective. This is not that much of a surprise given the unsettled issues among major EU members.

The *chapter on energy*, likewise, can not be considered as opened in substance as the EU has not managed to elaborate a joint strategy, basically due to Austrian and German misgivings over the longer term use of nuclear energy in the candidate countries. While some misgivings on notorious projects like in Kozloduj plant in Bulgaria seem justified, in other cases, as in the new nuclear plants of Mohovice in Slovakia or Temelin in the Czech Republic, it is hard to reconcile the combattant stance of the EU with practices in its member-states such as France.

Following Helsinki the priority of the EU has been to *assist latecomers* in their catching up. This legitimate priority has had two implications. First former second round countries could relatively easily open some chapters, while in case of others the need to operationalise the *acquis screening*, a phase already concluded by first run candidates, proved quite demanding. The *acquis*, in its majority, consist of technical legislation, where the screening phase is on the *implementation* experiences. Those countries who were lagging behind could not simply make up for the lost time by an accelerated pace of promulating EU laws, or making declarations of intent.

In case of labour market recent empirical work (Brücker, 2000) has reconfirmed earlier findings on the relatively *low mobility* of workforce in general and in the central European region in particular. However both the right wing government in Austria and the left wing government in Germany have already indicated their intention to ask for a ten year transition period when freedom to work would continue to be regulated by quotas.

This is poor economics, since analysis (Sinn, 1999) has shown labour migration to be a transitory phenomenon, unless overgenerous welfare payments create incentives to free ride. Moreover *shuttling* rather than mass *redeployment* seems to be the most likely outcome of opening up the labour markets. Last but not least, recent years have shown more inflow than outflow of people to central Europe, due to lower living expenses and due to the migration of qualified young managerial and skilled cadres in the multinational businesses.

In the above case what we observe is one of the fundamental features of such a historic change, in which not only the objective processes and numbers matter, but the *perception* of these by the electorate. In the latter terms the growing welfare disparities and labour migration are both perceived by the median voters as direct threats to their well-being (Brusis, M, 2000, pp.266-271 and 276-278).

Looking from this angle it is important to highlight the role of the media reporting primarily over the catalysms in the east. Transforming countries for a median television viewer would imply basically the Chechen war and calamities of ethnic cleansing in Kosovo, while features of more "normal" life in the Czech Republic or Slovenia have no reporting value. The predominance of local and regional press over national quality media also implies a decline in the foreign policy orientation of the median voter. As a result the de-emphasis on enlargement and the *low popularity of this objective is hard to overcome*. This is a problem in so far as even if expert level talks were to conclude quickly, 15 legislations need to approve with majority voting the favourable outcome.

But also in the accession countries *voices critical of the EU* have intensified. This is not necessarily a warning sign, as it also reflects that talks have reached a serious phase, with matters of substance being debated. But opinion polls, e.g. of Estonia, Slovenia or Poland, i.e. typically favourite countries, recently hardly show a majority favouring EU membership. Political leaders in other countries also continue to raise the issue whether there is life outside the EU, or whether their country would actually get the condition it "deserves" from the Union.

On a more pragmatic level EU matters have already turned into *instruments of domestic political rivalry*, which may be just a bit too early for successful accessions. In the case of Poland though the élite is across the board pro-European, vested interest politics, competition for favours of the farming interest and the rural population have made intransigent policy stances politically lucrative. The latter in turn antagonised the EU, and the severed relationship has revealed the fragility and limited embeddedness of Polish political structures, much contrary to the image of the country as a frontrunner of democracy in the region (Blazyca and Kolkiewicz, 1999). For the time being there is no longer any certainty, neither in Germany or France, nor in Poland that any enlargement must include Poland in the first round.

Likewise the *Czech Republic* has been paying a heavy price for the shopwindow policies of the 1992-96 period. The protracted pains of transformation have been exacebated by the very bad name the poorly regulated Czech financial market earned, domestically and abroad, following a series of scandals. The court cases on corruption involving senior members of both major parties have inflicted a wound on the image of Czech democracy. The governmental decision to build the Temelin nuclear power plant has been timed to a point when environmental movements just acceeded to governmental power in Germany and France. The overall *credibility problem*, exacerbated by the ongoing economic scandals, have strongly dicounted the value of formal progress made in law harmonisation. The languague used in the Commission's 1998 and 1999 country assessment is certainly indicating a gap between the progress of that country and its image. Interestingly the major conservative party ODS follows as much a Eurosceptic line as does the major opposition party, the communists.

In case of *Hungary* the center-right coalition has adopted a much tougher languague in safeguarding national interests. This however had little influence on the actual conduct of affairs. While in the first round lobbies managed to ask for over 45 transitory periods, this has been slimmed down to 30. Many of these are issues of next to no importance. The request e.g. to grant a 15 year transitional protection for Hungarian airlines is unlikely to be sustained as long as privatisation to a major air-carrier alliance takes place and makes it irrelevant.

The true stumbling blocks may be spotted in three areas. First, the earlier described lack of administrative capacity may *pre-empt the use of any commodity* funds, and so could the lack of co-funding.

Second, costs for *environmental clean-up* tend to be regularly *underestimated*. Enforcement of legislation of

EU standards is though in the best interest of the nation, however its costs are not realistically assessed and even less regularly budgeted in the current medium term fiscal guidelines. This is likely to lead to an accumulation of tasks and costs. Last but not least fiscal planning is unprepared as yet to operate with large enough pre-committed co-financing, which is though earmarked in the budget, but can *not be spent* on other objectives in the course of usual governmental improvisations. In this respect the declining financial independence of municipalities and the *delays in regional reforms* - creating 7 regions in the place of 19 historic countries - may become themselves *new technical barriers* to drawing on substantial EU funds.

In a view floating currently in Brussels, besides Hungary Estonia and Slovenia would qualify, if a quick accession would be mandated by changing strategic considerations. This may well reflect the current state of affairs. However the EU seems unlikely to extend *security guarantees* on its own, which would make the two small nations' fate dependent upon NATO decisions. Their quick accession to NATO looks to be an unlikely outcome.

To sum up, practical evidence is running against an *en masse* enlargement vision. *The EU* has not only its own *tradition of incrementalism*, but the growing diversity of subjects and reactions, limited funding, and equally scarce administrative capacity, *allow only for a gradualist approcah.* It would certainly be premature to judge the outcome, and even less the positioning of individual countries. What seems likely is a *go-slow strategy*, where the needs to act in an unplanned fashion, e.g. on Croatia, or according to the Stability Pact even on Serbia-Montenegro may dominate, but not *fully overshadow* organic progress in accession talks with more advanced countries. Slovakia and Croatia have sizable though in 2000-2002 underutilised catchup potentials. Meanwhile, the political load of a divided Cyprus, or a financially less than stable Malta under nationalist leadership, should not be underestimated, only for their being underreported in the international press.

The interesting and paradoxical conclusion of this state of art report may be advanced as follows: the success of accession negotiations may be much more *exogenously* determined, than parties in the bilateral talks seem to recognise. Just like in the case of Portugal in 1981 and Greece in 1986, or even with the pre-set date for Nordic enlargement by 1995, *strategic decisions by the EU based on vision*, not penny-wise cost calculation, *that are likely to prevail.* But when - it is an other matter, that nobody can foretell.

Notes

(1) This has been reflected in the insightful intervention of General Jacques Klein on the Second International Conference of the Hungarian Atlantic Society entitled "The Common Security and Defence Identity of the EU", Budapest, 3-4 March, 2000.

(2) This is reflected by the lastingly defensive position of EU during WTO talks.

(3) Though it is doubted by the report of the three wise men, as reported in: *Financial Times*, 9 Sept, 2000.

(4) This point - i.e. the supreme need to observe the common code of conduct, including a shared fiscal philosophy - has recently been emphasized by Braga de Macedo (2001).

(5) If the Balassa-Samuelson effect points towards an appreciation pressure, delayed fiscal consolidation may result in downward pressure, that sizable external disequilibria, reported in Table 1 may also exacerbate. The final balance of

the three factors is not necessarily zero and prompt conflicting market expectations, triggering enhanced exchange rate volability in candidate countries. A devaluation may not be a disaster *per se*, but if happens in an enforced manner, it surely undermines overall policy credibility in terms of Emu maturity. Even a floating zloty should *not* experience radical real depreciations in this context, while open economy macroeconomics should suggest the use of this instrument as long as it is yet available.

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