

# *EU Enlargement to the East: Effects on the EU-15 in General and on Austria in Particular*

## *An Overview of the Literature on Selected Aspects*

Jarko Fidrmuc,  
Gabriel Moser,  
Wolfgang Pointner,  
Doris Ritzberger-  
Grünwald,  
Paul Schmidt,  
Martin Schneider,  
Alexandra  
Schober-Rhomberg,  
Beat Weber

### **I Introduction**

Two completely divergent vantage points might be applied to analyze the economic effects of the imminent Eastern enlargement of the European Union (EU): On the one hand, the state of the preparatory work and the catching-up process in the Central and Eastern European countries (CEECs) themselves may be analyzed. On the other hand, the possible effects of enlargement on the EU Member States may be examined. The latter angle was chosen for this survey of the literature, with a specific emphasis on macroeconomic impacts. The survey is designed to acquaint the reader with enlargement issues without anticipating the statements made in the individual studies in this issue of *Focus on Transition* and in *Focus on Austria* 2/2002.

The set of aspects scrutinized in the literature survey begins with the assessment of the effects of EU enlargement toward the East on growth and welfare in the current EU Member States. Numerous surveys come to the conclusion that in the long run, EU Eastern enlargement will have positive – albeit rather small – effects on the economic growth of the EU-15. Most of the models capture a ten-year horizon. The results vary between 0.0 and 0.8 percentage point; the European Commission forecasts cumulative additional GDP growth to run to 0.5 to 0.7 percentage point. The macroeconomic effects on Austria are greater, because the country has more intense economic relationships with the region: numerous studies identify growth effects ranging between  $\frac{3}{4}$  percentage point and  $1\frac{1}{2}$  percentage points.

With a free trade zone between the EU and the associated countries having been established, most of the trade effects have already taken place; hence, the above estimates do not refer to trade effects. Therefore, most of the process of trade intensification has already come about since the opening up began in the early 1990s, with the exception of special products such as agricultural goods. As a small open economy located at the perimeter of the CEEC region, Austria has benefited to an especially great extent from the opening up of Eastern Europe: In 2000, some 11% of Austria's imports derived from the CEE accession countries and about 13% of Austria's exports were delivered to that destination. As a consequence, Austria has the strongest economic ties to the region of all EU countries.

The financial effects of EU Eastern enlargement represent a second aspect of this literature survey. The literature goes into possible impacts on capital flows (it should be noted that the liberalization of capital transactions has been largely completed) and into the effects of financial sector deregulation. While the danger of financial crises grows as markets are liberalized, so does the opportunity for growth. In this light, it is essential that a suitable institutional environment be established so that both the current Member States and the accession countries reap the advantages of deregulation in the long run. Austrian hopes to develop the Vienna stock exchange into a popular market for Eastern European equities have not come to fruition yet. Currently, only few equities are listed on the NEWEX (New Europe Exchange), and sales are low. Much rather, national locations, such as the Budapest or Warsaw stock exchanges, are striving to gain a foothold among the plethora of European stock exchanges.

Like trade, foreign direct investment (FDI) was intensified in the 1990s, although investment in the CEECs is much higher than in the opposite direc-

tion. Whereas low unit labor costs and a number of other locational advantages prompted Western European companies to invest in the CEECs, these countries have still invested only little in Western Europe.

Another chapter of this survey reflects on the possible influence of enlargement on the labor market. The estimates patently signal the great uncertainty attached to this issue, as they cover an unusually broad range: Between 41,000 and 680,000 persons are expected to migrate to the EU after enlargement or after the transition period restricting the free movement of persons ends. It is fairly certain that the migration flows will differ strongly from country to country, depending on the income differentials, the relative tightness of the labor market and the geographical proximity of the countries. Accordingly, Germany and Austria are sought-after targets for many potential migrants; in addition, the volume of commuters in the border regions is expected to augment.

Apart from the crowding out on the labor market that enlargement is likely to entail, the migration of generally young and highly motivated labor will have positive effects both on economic growth and the social security systems of the EU countries. Considering that different countries will be affected to varying degrees, experts endeavored to develop an appropriate solution and found one in the flexible transition period of seven years agreed in 2001. This regime enables countries anticipating above-average migration rates to proceed step by step and to implement active labor policy measures. As the enlargement of the EU toward the South showed, however, France did not take full advantage of the restriction it had originally insisted on.

The impact of EU enlargement will vary not only from one EU Member State to another, but also from region to region. This key statement of the next part of the literature survey is based on the experience gained to date with the opening up of Eastern Europe. Regional competitiveness is based not just on geographical proximity or the fact that two countries share a border; the differences between types of regions are also essential determinants of competitiveness. Adjustment is most difficult for the peripheral regions, but quite often, it is no more than simply an acceleration of the structural change required anyway. It comes as no surprise that the regionally different effects of the opening up of Eastern Europe have already been analyzed in depth using Austria as an example: While large urban areas have benefited from the opening, rural border regions have lost their principal locational advantage, namely supplying labor-intensive industries with cheap labor. An issue which has not been settled yet is whether EU enlargement will reinforce or temper regional disparities. Appropriate regional and economic policy measures at the EU and at the national level are particularly crucial to cope with such disparities.

EU and Austrian finances represent the last issue surveyed in this contribution. Enlargement will entail a reshuffling of finances, either in the form of supplying the Structural Funds and the Cohesion Funds with more money, or of redistributing funds from the current recipient countries, above all the cohesion countries Portugal, Spain, Greece and Ireland, to the newly acceding CEECs. This option appears quite viable, considering that the catching-up process in some of the cohesion countries (take Ireland, especially) has progressed very far.

A key issue – retaining the own-resources ceiling – was contested for a long time. Individual studies come to different conclusions based on different assumptions about the actual date of accession, the speed of the cohesion process within in the EU-15, the extension of existing promotion measures to the newly acceding member countries and the type of transition provisions put into effect, if any. The EU Commission has just recently estimated the cost of enlargement to the EU budget on the assumption that ten countries would join in 2004. With total payment commitments of EUR 40.16 billion for the period from 2004 to 2006, EU budget expenditure would run to 1.08% of GNP, thus remaining below the own-resources ceiling of 1.27%. Overall, according to the European Commission's estimates, 0.09% to 0.14% of the enlarged EU's GNP would be earmarked for expenditure for the new Member States.

The next financial forecast for 2007 to 2013 will probably not be fully negotiated before enlargement, which could be under the Finnish Council presidency. The negotiation results of the current enlargement round will determine to what extent a thorough overhaul of the EU budget will be required then. Already today, there are signs that agricultural policy will be restructured and that the means from the Structural Funds will have to be redistributed to the newly developing regions.

The calculation of the effects on the Austrian budget are still at a very rudimentary stage, because the negotiations on numerous essential chapters have not been concluded yet (e.g. agriculture) and because it is uncertain by how much budget receipts will shrink if tobacco tax revenues should decline. First estimates point to a marginally positive net impact on the Austrian budget. If the European Commission's current expenditure proposal is calculated for Austria, Austrian contributions to the EU would rise by a total of EUR 670 million from 2004 to 2006.

Preparations for the accession are currently making swift progress, as the accession negotiations show: Most of the negotiation chapters with the majority of applicant countries have already been provisionally closed. The speed of the preparations for accession also puts the implications of enlargement for EU institutions into the limelight. The work of the Convention on the future of the EU is presently focused on keeping an EU with up to 27 members operational and on changing the structures of EU institutions accordingly. The contribution by Lindner and Olechowski-Hrdlicka, published in *Focus on Austria* 2/2002, covers this issue, with a special emphasis on the areas related to economic and monetary policy.

## **2 Growth and Welfare Effects of EU Enlargement to the East**

For over 50 years, Western European countries have experienced a period of strong growth (on average) assumed to have been fostered above all by trade liberalization (Frankel and Romer, 1999). In the 1990s this Western European integration was strengthened by the creation of a Single Market in Europe, the EU accession of three EFTA member countries and, last but not least, by the introduction of the single currency.

Crespo-Cuaresma, Dimitz and Ritzberger-Grünwald (2001; in this issue of *Focus on Transition*) show that formal EU accession has positive effects on the

growth of all EU Member States. The growth effects, however, are not linear: On the one hand, the positive impact of EU membership augments with the duration of the integration period, and on the other hand, countries with a lower per capita income benefit relatively more from integration than more wealthy member countries.

A comparison between Western European countries and the former planned economies in Central and Eastern Europe distinctly shows how much more efficient largely liberalized market economies are. Therefore, it comes as no surprise that the CEECs linked their economic reform with the gradual integration into the EU from the outset. To this end, the EU and the ten applicant countries signed Europe Agreements.

The Eastern enlargement of the EU will trigger the following economic effects (for a detailed presentation, see Fidrmuc and Nowotny, 2000, or Kohler, 2000):

- The traditional trade effects (Viner, 1950) may be positive (trade creation) or negative (trade diversion). The countries bordering on CEE (above all, Austria, Germany, Sweden and Finland) benefit more than the remaining EU Member States.
- Factor migration has different effects on source and on target countries: Immigration boosts growth in the EU whereas production outsourcing (direct investment in CEE) reduces it.
- The dynamic effects (capital accumulation, improved access to new technologies, increased competition and gains due to increased returns to scale) possibly constitute the majority of the long-term effects of economic integration (see Baldwin, 1993, and Baldwin and Venables, 1995). The dynamic effects of integration are asymmetric, with a relatively low impact on today's EU members and a possibly large impact on acceding countries.
- Eastern enlargement of the EU is generally not expected to have significant macroeconomic impacts on the EU-15 (see table 1). However, financial transfers to the new members could severely burden the EU budget by raising contributions for net payers and/or by diminishing transfers from the EU budget to net recipients. Moreover, the short-term adjustment costs caused by migration in addition to foreign trade might be quite substantial in some sectors.

Most of the adjustment cost in the applicant countries arose before accession, having been caused by the adoption of the *acquis*, the EU's body of law (see Inotai, 1999, and the 2001 Regular Reports of the European Commission). For some time, the EU has faced allocation effects caused by the establishment of a free trade area between the EU and the associated countries on account of the implementation of the Europe Agreements.<sup>1)</sup>

Considering the wide variety of effects to be expected and the broad range of empirical methods used (above all, macroeconomic forecasting models and Computable General Equilibrium Models, or CGEM), only a few effects were

<sup>1</sup> Section 2 compares the economic effects of the opening up of Eastern Europe and Eastern enlargement of the EU.

examined in depth. Table 1 lists the available estimates of long-term<sup>1)</sup> effects on the European Union and on Austria; short-term and migration effects are left out of account here. However, the studies presented in this survey are based on differing assumptions about the budgetary framework of EU Eastern enlargement and about the extent of dynamic effects.

On the whole, Eastern enlargement is expected to produce small but positive growth effects on the EU. In the short run, though, Eastern enlargement may well have negative effects, too, above all in the migration target countries and in the countries that face higher transfers to the EU or reduced payments from the EU budget. EU Eastern enlargement is seen to foster growth in the accession countries, a feature generally referred to as a stability export to the adjacent regions.

The first study that reviewed the economic impact of EU enlargement to the East was written by Gasiorek, Smith and Venables (1994) and is based on the authors' earlier papers on the effects of the Single Market (see Smith and Venables, 1988, and an ex-post assessment by Allen, Gasiorek and Smith, 1998). The CGEM covers 13 industrial sectors typified by imperfect competition, the financial sector and the rest of the economy (denominator). Seven EC regions (not including Austria, which only joined in 1995) were modeled individually, while the applicant nations, along with the EFTA members and the rest of the world, formed a separate aggregate. EU enlargement to the East was simply simulated by increasing foreign trade on the basis of estimates by Hamilton and Winters (1992). The model also takes into account dynamic effects and capital reallocation (full capital mobility), however, whereas labor is not taken as mobile, not even within the EU. The emphasis on the dynamic effect within the framework of imperfect competition may explain why the figures come out somewhat higher (0.5 to 0.8 percentage point of GDP) than in later studies.

Baldwin, Francois and Portes (1997) develop two scenarios on the impact of EU enlargement. The first, more conservative enlargement scenario prepared by the authors is currently recognized as the most important reference for the possible effects of EU Eastern enlargement. The authors simulate the effects of enlargement, using seven countries (the associated countries exclusive of the Baltic republics) in a CGEM extending to seven regions (CEE-7, EU-15, EFTA-3, the former USSR, NAFTA, Asia and the Pacific region, North Africa and the Middle East, Africa and the rest of the world) and 13 sectors. Most of industry is characterized by increasing returns to scale and imperfect competition, but for the primary sector and the textile industry, the authors assume constant returns to scale and perfect competition.

Baldwin, Francois and Portes model EU Eastern enlargement chiefly as a 10% decline in bilateral real trade cost. Moreover, upon joining the EU, the new Member States adopt the EU's external customs duties, which will result in marginal effects also on third countries. In addition, investment in the acces-

1 The long-term effects show the cumulative difference between the basic scenario (no Eastern enlargement) and a possible variety of enlargement scenarios. Usually, a time horizon of ten years is considered sufficient in the macroeconomic forecast and simulation models (analyzing economic developments in the five to seven years following EU Eastern enlargement). The CGEM are used to analyze the differences between the various steady states (i.e. between the long-term growth paths) in both (or in several) scenarios.

sion countries will mount as a consequence of the drop in the risk premium and (in the alternative enlargement scenario) the risen demand of these countries for capital. The latter assumption barely has an additional effect on the current EU (0.2%), although the impact on the applicant countries in the alternative enlargement scenario is considerably greater (18.8 versus 1.5 percentage points).

The European Commission (2001) chooses an entirely different method to simulate Eastern enlargement, namely the Solow growth model (SGM). While this approach may provide useful insights to explain the growth contribution of the individual production factors in the transition countries, it is unusual to apply this supply-side model to the EU. Unlike earlier studies, the Commission's study sees the effects of enlargement to the East as stemming exclusively from indirect effects, i.e. effects produced by the allocation of labor and capital, and from factor productivity. This prevents the comparison of the individual results across studies, though the overall results of the EU study are not much different from those of other studies. The EU Commission predicts slight positive effects on the order of 0.5% to 0.7% for the EU. Kohler (2000) and Breuss (2001) also found effects of this magnitude, while Lejour, de Mooij and Nahuis (2001) as well as Neck, Haber and McKibbin (2000) calculate a much lower impact.

A comparatively large number of studies detail the economic impact of Eastern enlargement on Austria. This may be explained both by the important status of EU enlargement to the East for Austria's economy and by Austria's tradition of applied economics and quantitative analysis. In addition, suitable methods of empirical research were developed to assess the economic impact of Austria's EU accession (see Breuss, 1992, and Keuschnigg and Kohler, 1996) and could now easily be adapted to EU eastward enlargement.

Breuss and Schebeck (1995 and 1998) simulate EU Eastern enlargement using WIFO's macroeconomic model for medium-term forecasts. Breuss updated these estimates and expanded them to include the EU as a whole, applying Oxford Economic Forecasting's World Macroeconomic Model. By contrast, Keuschnigg and Kohler (1997 and 2000) base their simulations of EU Eastern enlargement on a dynamic CGEM. The model assumptions, though, are broadly the same across all studies. The basic assumption of the enlargement scenarios is a 5% to 10% reduction of real trade costs. Additionally, the studies take into account the budgetary impact of enlargement on Austria. The latest available versions of both simulations include migration, but the partial results were not included in table 1, as they are not comparable to the results of other studies.

Although different models were used, the results of the simulations are very similar, reflecting the homogeneity of assumptions. While the impact of EU enlargement to Eastern Europe is higher for Austria than on the EU average, it is nevertheless fairly small at  $\frac{3}{4}$  percentage point to  $1\frac{1}{2}$  percentage points.

If EU enlargement to the East were delayed, the integration gains would be postponed (see Breuss, 2002, and Schneider, 2002). In the short run, the total of foregone integration gains may be quite high. According to estimations presented by Breuss (2001), the important trade effects just for exporters (the effects of reduced real trade costs, that is, among other things resulting from

the elimination of delays at the border) amount to roughly 0.13 percentage point of Austrian GDP a year. While these effects might not appear impressive at first glance, Breuss (2002) underlines that extrapolated over six years (corresponding to a delay in enlargement to 2010) foregone trade simplification would total 0.8 percentage point of Austrian GDP. This result supports the finding that by comparison to other EU members, Austria would stand to lose disproportionately from a postponement of CEEC accession.

Table 1

**Long-Term Cumulative Effects of EU Eastern Enlargement  
on the European Union and on Austria**

	Method	GDP Growth	Source
EC-12	CGEM	0.5–0.8	Gasiorek, Smith and Venables (1994)
EU-15	CGEM	0.2	Baldwin, Francois and Portes (1997)
EU-15	CGEM	0.1	Kohler (2000)
EU-15	CGEM	0.0	Neck, Haber and McKibbin (2000)
EU-15	SGM	0.5–0.7	European Commission (2001)
EU-15	MEM	0.3	Breuss (2001)
EU-15	MEM	0.1	Lejour, de Mooij and Nahuis (2001)
Austria	MEM	1.6 <sup>a</sup> –1.7 <sup>b</sup>	Breuss and Schebeck (1995)
Austria	MEM	1.3 <sup>b</sup>	Breuss and Schebeck (1998)
Austria	CGEM	1.4–1.5 <sup>c</sup> , 3.6–3.7 <sup>d</sup>	Keuschnigg and Kohler (1997)
Austria	CGEM	1.1 <sup>a</sup> –1.3 <sup>b</sup>	Keuschnigg and Kohler (2000)
Austria	MEM	0.7	Breuss (2001)

Source: OeNB.

Note: CGEM: Computable General Equilibrium Model, MEM: macroeconomic model, SGM: Solow growth model; a: accession of five CEECs, b: accession of ten CEECs, c: basic scenario with different EU budget reform assumptions, d: optimistic scenario with different EU budget reform assumptions.

### 3 Effects of EU Eastern Enlargement on Trade Relations

Conjectures about the impact of EU enlargement to the East draw heavily on the effect of the opening up of Eastern Europe at the beginning of the 1990s, above all in Austria and in some neighboring countries. During that phase, trade effects were the most predominant effects. Within the first five years after the fall of the Iron Curtain, the share of the EU-15's imports from the associated countries doubled (see table 2). On the EU-15 average, however, imports from the CEECs remained marginal (below 3% in 1994). In Finland, Austria, Germany and Greece, imports from and exports to the CEECs, however, had already expanded substantially by the mid-1990s, with imports from the region containing a fair share of sensitive goods (such as agricultural products, steel, textiles and automobiles)<sup>1</sup>).

These effects were especially strong for Austria as a small, open economy (GDP share of foreign trade) that is situated close to the CEECs. The positive effects of the new export markets clearly outweighed structural problems caused by surging imports. Breuss and Schebeck (1995) estimate the long-term macroeconomic effects of the opening up of Eastern Europe from 1989 to 1994 to a total of 2.4 percentage points of GDP. The majority of these effects (1.3 percentage points) were attributable to trade, and an additional 0.9 per-

1 Neven (1995) and Fidrmuc, Huber and Michalek (2001) discuss sensitive goods in the context of the Europe Agreements. Grossmann and Helpman (1994) analyze this topic in the theoretical framework.

centage point to German reunification and stepped-up migration to Austria (only partly from the CEECs).

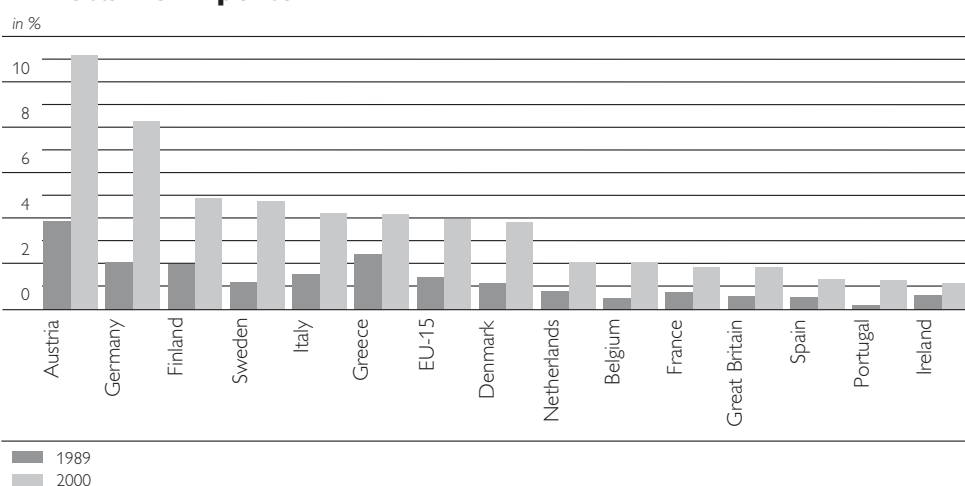
In the case of EU Eastern enlargement, the weights of the individual effects are likely to be different. Since 1997 the EU has removed customs duties on imports (except on agricultural products and selected sensitive products). Accordingly, in the wake of the elimination of border controls, Eastern enlargement will entail only a comparatively marginal reduction of real trade costs. According to Breuss (2001), various estimates of these cost reductions have been made, all in a narrow range of between 5% (e.g. Kohler, 2000) and 10% (Baldwin, Francois and Portes, 1997). Even assuming the greatest estimated reduction, the trade effects are small according to Breuss (2001), coming to a cumulative 0.05 percentage point of the EU-15's GDP between 2005 and 2010<sup>1</sup>) and ¼ percentage point of GDP (the highest value within the EU) for Austria. Hence, the trade effects represent just a fraction of the overall macroeconomic impact of EU Eastern enlargement.

The structure of trade between the EU and the associated countries has become much like that of intra-EU trade, which enhances the welfare effects of further trade liberalization. The higher shares of intraindustrial trade – trade between the same industrial sectors – bears witness to this shift in trade structures. Fidrmuc (2001) shows that taking into account the size of the countries and their geographic position, the shares of intraindustrial trade in the EU's trade with the East have already fully adjusted to the values of the Single European Market. This points to relatively low future adjustment costs, although there are still substantial quality differences between the traded goods (see Aturupane, Djankov and Hoekman, 1999).

Chart 1

**Share of Imports from the CEE Accession Countries**

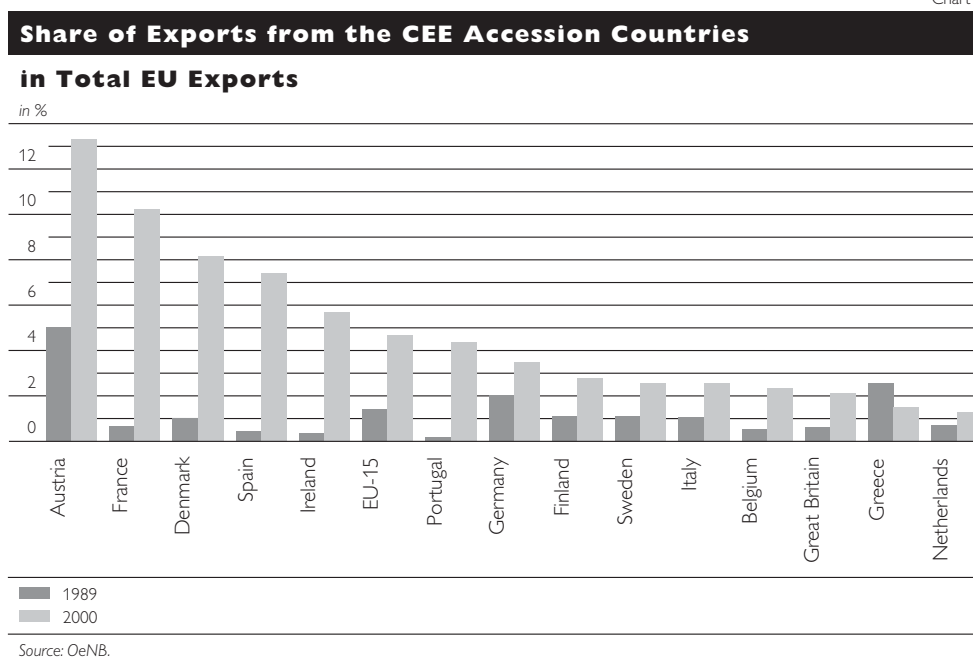
**in Total EU Imports**



Source: OeNB.

1 The European Commission (2001) estimates the trade effects of Eastern enlargement at 0.0 to 0.1 percentage point.

Chart 2



#### 4 Liberalization of Capital Transactions, Financial Deregulation and Financial Stability

The adoption of the EU's body of law upon EU entry calls for the liberalization of capital movements and of financial markets in the accession countries as well as the establishment of institutions to secure stable prices and financial markets (Lannoo, 2001), although derogations may be applied in some areas. In the past years the development of accession countries' financial sectors and their legal as well as institutional settings were characterized by gradual progress toward achieving these goals (Tison, 1999, and Ems, 2000)<sup>1</sup>) in the course of the implementation of the Europe Agreements (in the first half of the 1990s).

The empirical literature on the relationship between financial deregulation and financial stability points toward a tradeoff – financial deregulation increases the probability of financial crises while simultaneously boosting economic growth. Demirgüç-Kunt and Detriagache (1998) indicate that countries frequently experience a financial crisis several years after deregulation. An important factor triggering financial crises is the institutional setting, which determines the extent of factors such as corruption, the collectibility of contractual claims and bureaucratic inefficiency. Another important consideration is the reduction of profit margins in banking caused by more intense competition. On the other hand, a more developed financial sector has positive effects on growth.<sup>2</sup>) All in all, the authors conclude that the institutional framework – above all financial system supervision – must be improved before further liberalization steps are taken. Only if the institutional setting is enhanced will the positive effects of deregulation outweigh the negative effects.

1 DG EcFin (2000) contains a survey of the current state of capital movements liberalization.

2 The literature survey in Levine (1997) summarizes the growth effects of financial deregulation.

According to Edwards (2001), the development state of the financial sector in terms of the GDP ratio of the banking sector's liquid liabilities is also an important benchmark for the impact of the removal of capital controls on economic growth. The elimination of capital controls tends to have a negative impact on less developed countries. Klein and Olivei (1999) come to similar conclusions.

Schröder (2001) emphasizes the positive effect of financial deregulation and capital account liberalization for international investors. He states that including accession country stocks in an internationally diversified portfolio can theoretically produce better return-to-risk ratios (known as Sharpe ratios). In the simulations performed with stock prices from 1994 to 1998, this effect could not be confirmed (on this subject, see also the contribution by Ludwig and Schlagbauer on "The Integration of Eastern Europe – Effects on Stock and Bond Markets" in the OeNB's Focus on Austria 2/2002).

Benoit, Schantl and Weyringer (2001) examine the effect of financial liberalization in the accession countries on Austria. According to the authors, the Vienna-based NEWEX could become an important trade center for CEE stocks (see also Obersteiner, 1999). Until now, however, these hopes have not materialized. The reasons are as follows: Principally, only few CEE companies go public. They privatize mainly via strategic partners or in the form of Global Depositary Receipts (GDR) at the London Stock Exchange. The few listed CEE companies generally prefer their domestic stock exchanges. While some Eastern European stocks are traded on NEWEX, most of them are Russian.

#### 4.1 EU Investment in the Accession Countries

FDI in the accession countries was strong in the 1990s. Buch (1999), for example, compares the saving-to-investment ratio in the accession countries and in the Southeastern European accession countries, showing that the integration of the accession countries in world financial markets is already comparable to that of advanced OECD member countries. Lankes and Stern (1997) establish a positive link between individual CEECs' capital inflows and their progress in the transition to market economies and the degree of macroeconomic stabilization. Garibaldi et al. (1999) determine that the accession countries experienced roughly the same scale of capital inflows as Southeast Asia and Latin America until 1997. Approximately two thirds of the applicant countries' capital imports originated in the EU; nevertheless, the total share of remained relatively low 0.15% EU GDP (DG EcFin, 2001).

The different factor endowments in the two regions are regularly cited as the economic rationale for the west-east capital flows. As assets per employee are lower in the East than in the West, every additional unit of capital invested delivers higher marginal returns in the East than in the West. Capital flows continue until the marginal returns in both regions are in equilibrium. In addition to capital stock convergence, the accession countries also benefit from political, administrative and legal convergence, which reduces the risk of investment by creating a stable institutional setting in the run-up to accession (Eichengreen and Ghironi, 2001; Baldwin, Francois and Portes, 1997; Lankes 1999).

Buch and Piazzolo (2000) present empirical evidence of an anticipated acceleration of EU portfolio investment, bank lending and FDI in the applicant countries upon accession. Using foreign investors' behavior in the past years as a benchmark, the authors estimate that claims of individual EU member countries<sup>1</sup>) are between 20% and 50% (with the exception of Austria) of the level expected if investment continues at the current pace for bank loans (figures for 1999) and portfolio investment (figures for 1998) and between 41% and 76% in the case of FDI (figures for 1997). The underrepresentation of the accession countries in the EU's foreign investment (with the exception of Austria) and the perceptible size of the enlargement effect appear to point to high future investment flows. This process may in fact be over for Austria (see also the contribution by Dell'mour in this issue); however, the quality of the model leaves some scope for further research, above all on the statements on FDI and portfolio investment. Sinn and Weichenrieder (1997) make similar statements about a comparatively low stock of FDI by the EU in Eastern Europe. Conversely, Brenton and Di Mauro (1999) do not find significant FDI underinvestment. Their forecast is based on a model estimate that explains FDI largely as contingent on a country's degree of economic freedom. The inclusion of these variables may be responsible for the fact that they do not find a significant EU effect for FDI. Considering that the degree of economic freedom changes upon EU entry, which would in turn lead to an adaptation of FDI stocks, their forecast may be questionable.

The macroeconomic effects on the EU of intensified capital flows to the CEE accession countries are largely summarized in four categories:

- Interest rate effect: Eastern customers' stepped-up demand for savings in the West induces short- and long-term real interest rates in Western Europe to rise. Breuss (2001) pegs the interest rate effect at 5 basis points for short-term and 20 basis points for long-term interest rates over the period from 2003 to 2010, caused by cumulative capital exports of around EUR 30 billion. Neck and Schäfer (1996) reach a similar conclusion. One feature accompanying higher interest rates is a higher real euro exchange rate on account of the international interest rate parity (DG EcFin, 2001; see also the contribution by Moser, Pointner and Backé "Exchange Rate Strategies of the Accession Countries on the Road to EMU: Impact on the Euro Area" in Focus on Austria 2/2002.
- Substitution effect: Investment made in Western Europe without the CEECs acceding would be made because of the better framework conditions there and because of lower labor cost in Eastern Europe. Altzinger (1998) points out that this effect has been limited to industrial enterprises so far, as they outsourced production to take advantage of lower labor cost. However, this motive has applied to only 10.5% of Austria's total FDI in the region. Breuss and Schebek (1994) expect this factor to produce marginal negative effects for Austria.
- Complementary FDI: FDI in Eastern Europe boosts Austria's, and the EU's, exports, e.g. on account of intracompany trade. Empirical evidence presented by Brenton and Di Mauro (1999) suggests that the positive effects

<sup>1</sup> The authors examine investment behavior for Austria, Germany, France, Italy, Belgium and the Netherlands.

of complementary FDI and the negative effects of substitutional FDI offset each other for most European countries, whereas the complementary (positive) effects predominate for Austria.

- Income effect: Investment in Eastern Europe results in a net positive international investment position (IIP) for the EU. This leads to future interest income and profits, provided the investments develop well (Kohler, 2000; Altzinger, 1998).

## **5 Effects of EU Eastern Enlargement on the Labor Market**

EU Eastern enlargement will trigger a stronger migration of labor to the EU, most likely first and foremost to Germany and Austria. This migration will face the labor markets in the countries concerned with novel challenges, which will be outlined below. After a general survey of the quantitative estimates of the expected migration volume, the expected impact on employment and income developments in Austria will be sketched. Finally, some labor market policy options to cope with the situation will be presented.

### **5.1 Migration Potential**

The gap between incomes in the EU and in the accession countries is expected to intensify migration from the CEECs in the wake of enlargement and the resultant free movement of labor. After Germany, Austria may be the main goal of migration, particularly because these countries and the CEECs share borders. The estimates of the figure of expected immigrants diverge sharply depending on the method used and the assumptions which are met. Some of the studies employ econometric models based on variables such as the real wage differential or the unemployment rate to estimate the number of expected migrants. These studies refer to the findings of Barro and Sala-i-Martin (1995), according to which an annual difference in per capita income of 10% induces the migration of 0.05% to 0.15% of relatively less wealthy persons. Using econometric methods, Walterskirchen and Dietz (1998) estimate a migration flow from the Czech Republic, Slovakia, Slovenia, Hungary and Poland of 42,000 persons a year to Austria for 2005, under the condition that full freedom of movement for workers has been granted by then. Thereafter, migrant numbers should recede as average wages converge. Hofer (1998) estimates annual migration at 23,000 to 46,000 persons. Faßmann and Münz (1996) underline the importance of the variables geographical proximity and income differentials. In a study based on a German immigration data set covering 17 immigrant source countries and the period from 1960 to 1994, Fertig (2001) comes to the conclusion that the anticipated migration flows will not exceed the immigration which occurred after Spain, Portugal and Greece joined the EU.

Brücker and Boeri (2000) estimated a time series model for Germany and applied these results to Austria. In their scenario, the authors assume that the above countries will enter the EU alongside the Baltic republics, Romania and Bulgaria already in 2002. They estimate immigration to the EU to run to about 335,000 persons in 2002. The distribution of these immigrants across the Member States is not even: Germany is anticipated to attract 218,000 persons, Austria 40,000; Spain, Belgium and the Netherlands some 4,000 migrants, while only 79 persons will seek work in Ireland. According to this study, Austria

and Germany alone are expected to absorb 77% of the immigrants from the countries named. While much uncertainty is attached to this study, its results are nevertheless generally considered a benchmark.

As Huber (2001) notes, on account of the long forecast horizon, all of these studies involve enormous uncertainty about the development of incomes in the countries reviewed. Straubhaar (2001) argues along similar lines, pointing out that migration trends are subject to great structural breaks stemming from substantial changes such as EU accession.

Other studies are based on surveys conducted in the CEECs in which respondents talk about immigration intentions after EU entry. Faßmann and Hintermann (1997) find a general interest in emigration in 20% of the total population of the Czech Republic, Hungary, Slovakia and Poland. However, only 8% have taken first steps, such as obtaining information about possible migration target countries. The number of persons who have already applied for official visas and employment permits for EU countries stands at 700,000 or 1% of the population of the countries covered. A fair share of these potential immigrants – 12.2% – have a university degree, and an additional 34.6% are high school graduates. This study, too, identifies Austria and Germany as the main target countries. In a household survey conducted in Hungary only, Sik (1998) researched emigration intentions, concluding that they are much weaker than other studies assume and that they are limited to border regions.

After enlargement, the Austrian labor market will face not only the impact of migrations flows, but also that of commuters. Huber (2001) estimates that 85,000 commuters will come to Austria daily from adjacent CEECs; Walterskirchen and Dietz (1998) peg this figure at 150,000 persons. Unlike migrants, who are distributed more or less evenly throughout Austria, commuters increase the labor supply above all in the eastern border regions and in the urban areas of Vienna, Graz and Linz.

Overall, depending on the method applied, the applicant countries examined and the time horizon selected, estimates of the migration potential diverge sharply across studies. Comparing 24 current studies, Huber (2001) finds that they forecast a range of 41,000 to 680,000 immigrants a year to the EU after enlargement. The large gap between these two figures shows just how important the choice of initial parameters is. While the lower figure results from calculations based on immigration indices, the higher figure derives from a gravity model of the type used by Barro and Sala-i-Martin.

## **5.2 Effects of Migration on the Austrian Labor Market**

The effects of immigration will differ from profession to profession. Age and qualification are not the only determinants of the competition of immigrants with domestic labor. Although some prospective immigrants have a good education, most of them are bound to work in low-paid jobs below their qualification levels. In this connection, Faßmann and Hintermann (1997) speak of “anticipated dequalification,” meaning that well-educated immigrants assume that they will only find jobs for which they are overqualified, and adapt their job-seeking activity accordingly. Apart from the structure of the labor market, the number of expected immigrants is key to the adjustment process. As indicated above, the number of immigrants will differ sharply from Member State

to Member State. The possible impact of immigration on the Austrian labor market will be outlined below. Adjusted for the number of expected immigrants and the structure of the respective national labor market, these findings apply to other countries as well.

Basing their study on experience with the opening up of Eastern Europe, Winter-Ebmer and Zweimüller (1996) estimate the impact of immigration on the Austrian labor market. They conclude that a 1% rise in real immigration increases unemployment among male workers by 0.15%. However, they find no significant impact of immigration on white-collar employment and female employment. A similar picture emerges from analyzing the effect on wage levels. The wages of poorly qualified labor decline as migration increases; conversely, highly qualified persons may even expect incomes to climb. Young and seasonal workers will be most affected by wage reductions.

In a simulation model, Huber and Hofer (2001) calculate the impact of an inflow of 35,000 immigrants a year. They come to much the same conclusion about qualification: the better qualified labor market segment benefits from immigration, as it represents a counterweight to the increasing supply of less qualified immigrant labor. The impact on less qualified labor tends to be negative, raising the risk of unemployment and exerting downward pressure on income levels. The impact of immigration on wage levels has also been analyzed (see, e.g., the contribution by Hofer and Huber in Focus on Austria 2/2002). If annual immigration comes to 35,000 persons a year, the wage growth of male workers diminishes by 0.3 percentage point, that of sectorally immobile female labor by 0.5 percentage point. Hence, immigration in the wake of EU Eastern enlargement is likely to cause the wage gap on the Austrian labor market to widen even further.<sup>1)</sup> Immigration will have the greatest impact on foreign labor already working in Austria, though. With the Austrian labor market being strongly segmented, foreigners have only little opportunity for advancement or sectoral mobility, no matter what their origin or how long their stay in Austria is. Additional immigrants from accession countries therefore increase competitive pressure in these areas.

According to Huber and Hofer (2001), the expansion of labor supply caused by migrants will entail two adjustments, namely the creation of new jobs and the reduction of the labor force participation rate. Whether new jobs are created depends on the immigrants' job qualifications: the better their qualifications match the demands of the Austrian labor market, the bigger the chance of generating additional jobs is. An optimal matching of labor supply and demand would require efficient cross-border job procurement tools. The reduction of the labor force participation rate results from the displacement of female labor and older workers, both groups that are already underrepresented in an international comparison.

### 5.3 Labor Policy Options

Transition periods for labor mobility range among the most frequently cited measures to ease the impact of Eastern enlargement on the labor market. Such provisions are designed to buffer uncertainties about the migration potential.

<sup>1</sup> *Keuschnigg and Kohler (2001) also simulate similar effects of Eastern enlargement on Austria.*

One must not forget, however, that from 2012, Austrian labor supply will shrink for demographic reasons (see Biffl and Hanika, 1998). Stepped-up immigration from the CEECs could contribute to securing prosperity in the long run.

In May 2001, the EU Member States agreed on flexible transition periods of up to seven years before introducing full freedom of movement for workers. Within this period, member countries are to have the option to limit the influx of labor from the accession countries. Member States which do not expect immigration to cause difficulties on their labor markets may waive this provision. The applicant countries principally accepted these transitional provisions in their negotiations. However, the additional measures that need to be taken within the transition period to ease the adjustment on the labor market are crucial for the transition provisions to be effective.

More emphasis on selective migration – favoring the influx of specially qualified immigrants needed on the Austrian labor market – is also being discussed. While selective migration may prevent crowding out in certain segments of Austria's labor market, it will not help the labor market absorb more workers. Here is where an active labor market policy could play an important role. Active measures include qualification measures for specific groups of workers, including, e.g., immigrants already resident in Austria and persons with low qualification levels. Qualification measures contribute to strengthening immigrants' horizontal and vertical mobility on the labor market and may thus counteract a rise in unemployment or a reduction of the labor force participation rate stemming from migration.

## **6 Regional Effects of EU Eastern Enlargement**

The EU's enlargement toward the East presents a wealth of opportunities for European regions, but some countries will have to cope with temporary adjustment pressures. These pressures will vary from region to region: the countries which will be most affected are those that share borders with the accession countries, i.e. Austria, Germany and Italy. Issues of regional interest mainly comprise the convergence between the European regions, the situation of different types of regions (above all the regions along the current perimeter of the EU), newly evolving regional specialization patterns, regional competitiveness and the various transmission channels of enlargement effects.

### **6.1 Effects on European Regions**

Only few studies currently analyze the impact of Eastern enlargement on the regions of the current EU Member States (see, e.g., Alecke and Untiedt, 2001; DIW and EPRC, 2001; Mayerhofer and Palme, 2001). There are a number of case studies, though, which review individual regions as well as sectoral studies dealing with regional implications (e.g. RWI and EPCR, 2000). Convergence studies have been drawn up at the national and regional levels (Tondl, 1999). However, these studies only partly focus on EU Eastern enlargement, and their findings are often ambiguous. For instance, the most recent study on cohesion in the EU commissioned by the European Commission (DIW and EPRC, 2001) deals with the possible development of national disparities between the EU and the applicant nations and with the regional disparities between the accession countries, but not with the regional disparities within

the current EU. According to Huber (1998), enlargement will reinforce rather than offset regional disparities.

The enlargement will affect different regions in different ways: The regions at the periphery of the EU will face the most arduous adjustment process. Short-term adjustment problems will arise, above all as a result of structural weaknesses. Still, the structural changes in the border regions merely represent the acceleration of structural changes that are necessary anyway; moreover, the process of restructuring will not take long to complete. In the long run, the gains from a relatively more central position and the possibility of cross-border division of labor should open up new opportunities. In the long-established industrial regions and the predominantly agricultural regions, there will be winners and losers alike. The EU Regional Funds have succeeded in improving conditions for these regions so far. Because of their growing functional specialization, urban agglomerations stand to figure among the winners of Eastern enlargement.

The Eastern enlargement will create new regional specialization patterns, too. The establishment of new regional growth centers is bound to shift the current high-income core regions (the so-called blue banana encompassing London, Paris, Hamburg, Munich and Milan) to the east.

Apart from the change in accessibility, regional competitiveness plays a key role for the future development of the European regions (European Commission, 1999). Alecke and Untiedt (2001) examined how competitive German border regions are in the light of enlargement. The results show that in general, the border regions in eastern Germany and Bavaria do not have a favorable economic structure. Hence, enlargement will tend to aggravate adjustment problems caused by sectoral difficulties. Some regions should benefit, however, as enlargement will expand their demand potential.

The principal channels through which enlargement will impact on regions are trade flows, FDI, cross-border purchase flows, and commuter and migration flows. Moreover, the regional and agricultural policy reforms triggered by enlargement will also provide an important impetus. Enlargement will have a negative impact on the regions which currently receive means from the Structural Funds, but the exact regional effects cannot be assessed yet.

## **6.2 Effects on Austrian Regions**

Recent studies the impact of EU Eastern enlargement on Austria were compiled by Palme (1998), ÖIR (1999), Mayerhofer (1999) and WIFO (1999). The most up-to-date results are those obtained within the framework of the Preparity project completed in 2001 (Mayerhofer and Palme, 2001). The effects vary strongly depending on the type of region. The regions under review are classified as urban areas, agglomerations (centers and suburbs), rural border regions and other regions. The urban areas, e.g. Vienna, Graz and Linz, benefited most from the opening up of Eastern Europe. They are also set to benefit most from the enlargement at the outset. However, these advantages will diminish as time passes. Furthermore, the liberalization of services and the likely concentration of labor market effects in the wake of migration will put growing pressure on large cities.

The opening up of Eastern Europe already deprived the rural border areas of their main locational advantage, namely supplying cheap labor to labor-intensive sectors. Numerous production facilities, especially in the textile industry, were closed down. Retailers and industries in which demand seeks supply have already come under strong crowding-out pressure. Activities providing work and services inherently bound to the location of their demand (e.g. construction) will be subject to massive pressure once Austria's neighbors to the east join the EU. Regional labor markets in the border regions will suffer from commuter flows in the first years following the accession, whereas migration is projected to play a minor role in the border areas.

When Austria's new EU neighbors to the east catch up and the wage differential diminishes, this pressure is supposed to ease off; also, the regional labor markets have only a limited capacity to absorb new labor. The agglomerations are in a more favorable position, above all in the middle of the integration phase, when the advantages of higher returns to scale in the enlarged Single Market and of the vertical division of labor can be utilized.

Enlargement may pose more of a threat to manufacturing in agglomerations than in urban areas, but clearly less of a threat than in rural border regions. In addition, geographical location plays a crucial role: The impact on Austria's eastern and southern provinces is greater than on the western ones. Enlargement is not expected to have any effect on housing development structures in Austria. Thus, the premier challenge of the future is not coping with a change in regional location structures, but rather finding out how to make optimum use of the existing top locations, especially in agglomerations, and how to link up other locations to the development process in the agglomerations.

The authors of the Preparity project contend that no defensive regional policy measures are needed. Much rather, from the perspective of the regions, Eastern enlargement should be complemented by proactive regional and economic policy measures aimed at improving competitiveness. Such measures include specific promotion policies (above all for rural border areas, but also for large cities), the promotion of small and medium-sized enterprises, enhanced networks between the individual regions, cross-border cooperation, infrastructure development and the establishment of the legal prerequisites for regional development.

A number of studies examine individual sectors and regions in Austria (e.g. Mayerhofer, 1996; Huber, 1998; Mayerhofer et al., 1998; Institut für Gewerbe- und Handwerksforschung 1998a, 1998b; Nürnberger, Pflanzelt and Richter, 2000). However, it would exceed the scope of this overview to discuss their results here.

## **7 The Effects of Eastern Enlargement on the EU's and the Austrian Budgets**

EU Eastern enlargement will entail a repositioning of competing demands on the EU budget. There are two types of limits on the current Member States' appeals to obtain large shares of EU funds: First, activities at the European level are limited by the provisions of Article 5 of the Treaty establishing the European Community, which lays down the principle of subsidiarity. Second, limits on the financing of conceivable expenditure programs have been set. The EU has

committed itself to limiting EU spending to an own-resources ceiling of 1.27% of EU GNP until 2006. The enlargement will certainly cause a shift in claims and net burdens both within the EU-15 and among incumbent and new members. However, it will not be possible to determine exact figures for the current financial period running until 2006 until the accession negotiations have been concluded.

### 7.1 Total Costs

Assuming that ten countries accede in 2004 (and assuming that direct income support for farmers in the new Member States is introduced gradually), the European Commission (2002) projects total expenditures to amount to EUR 40.16 billion in 2004 to 2006. In this scenario, EU expenditure would amount to 1.08% of GNP, which is clearly below the own-resources ceiling of 1.27%. Overall, according to the European Commission's estimates,<sup>1</sup>) 0.09% to 0.14% of the enlarged EU's GNP would be earmarked for expenditure for the new Member States.

On the issue of structural support measures, the European Commission (2002) proposes raising aid granted to the new Member States by the Cohesion Funds to a third of total structural expenditure. As a result, support for the new Member States' structural policy would amount to EUR 10.4 billion in 2006 (EUR 31.2 billion for the EU-25).

Banse et al. (2001), who analyze cost scenarios for the 2007 to 2013 financing period in what is referred to as the DIW paper, conclude that the own-resources ceiling in place today would suffice to cover the cost of enlargement by 12 applicant countries. If incisive agricultural and structural policy reforms were implemented, the EU's operative expenditure (agricultural, structural and internal policy) would sink to 0.57% of EU-27 GNP in 2013 (EU-27 in 2013 without reforms: 0.78% of GNP). Even if the reforms were not implemented, the DIW study claims that the operative expenditure of the EU-27 would be about EUR 10 billion below the appropriation for 2006.

Unlike the DIW, Apholte et al., in an analysis published by Dresdner Bank (2001) consider a fundamental reform of the current system of agricultural and structural aid unlikely, citing the unwillingness of the current recipients of net transfers to negotiate this issue. According to the Dresdner Bank paper, if the system which is now in place is retained and if ten countries join the EU in 2005, the additional cost of enlargement would amount to EUR 44 billion in 2005. This would exceed the EU's own-resources ceiling, causing expenditure to surge to 1.4% of EU GNP.

The results of both studies (DIW and Dresdner Bank) diverge sharply, as Dresdner Bank assumes that all 46 of the EU-15's regions eligible for support will continue to receive aid and that they will be granted generous transitional provisions. However, the authors of the DIW study estimate that the majority of the EU-15 regions will outgrow their recipient status even without reforms. Moreover, by contrast to the Dresdner Bank study, the DIW does not include

1 Agenda 2000 (see European Council, 1999) had still estimated total expenditure at EUR 42.59 billion and had assumed the accession of six countries in 2002.

the cost of administrative expenditure, external policy areas and preaccession instruments.

After factoring in the agricultural and structural reforms resulting from the decisions taken at the Berlin Summit (Agenda 2000), Ferrer and Emerson (2000) conclude that the cost of enlargement could be close to EUR 30 billion.

Kohler (1999) reviews various estimates of the cost of enlargement. The “power politics” approach to estimating the budget impact applied by Baldwin, Francois and Portes (1997) comes up with enlargement costs of between 0.111% of EU GDP to 0.211% over a six-year period, depending on the parameters. Following Breuss and Schebeck’s (1998) econometric model of the EU’s agricultural and structural funds, Kohler adopts their estimate of 0.184% of EU GDP for the same period.

However, after the European Commission’s proposals on how to finance the enlargement from the beginning of 2002, a number of the assumptions in the studies mentioned above have become obsolete. Nevertheless, these contributions contain some very interesting points, as they reflect the great uncertainty about EU enlargement that have marked discussions about this issue for a long time. Since the future of agricultural subsidies is still in the dark, and since this area has been labeled an especially problematic issue for enlargement time and again, the reflections of various studies on this topic will be spelled out in more detail below.

## 7.2 Agricultural Subsidies

According to the impact analysis of Agenda 2000, applying the common agricultural policy (CAP) one to one to the applicant nations would be problematic. Considering the often enormous price differences between the accession countries and the CAP prices, even a stepwise introduction of the CAP would result in a slight overproduction, so that already existing production surpluses would be boosted further. Applying the CAP unrestrictedly would burden the EU budget with some EUR 11 billion a year, nearly two thirds of which would be earmarked for direct payments (compensation) to farmers. However, if the new members were not eligible for equalization payments (which would otherwise account for about two thirds of the additional payments), the agricultural guideline<sup>1</sup>) would probably suffice to finance enlargement-related additional costs if the planned CAP reforms are also taken into account.

The Structural and Cohesion Funds could retain their ability to make full equalization payments after 2006 only by violating the equal treatment principle, which appears to be problematic from the legal perspective. This outlook also creates considerable reform pressure for the EU’s agricultural policy (see also the DIW study, 2001).

The European Commission (2002) proposes a step-by-step introduction of CAP direct payments to the future members (staggered in stages of 25% – 20% – 35% until 2006 and 100% in 2013). According to the European Commission, the additional cost for agriculture will run to EUR 3.9 billion in 2006 (EU-25: EUR 45.6 billion).

<sup>1</sup> The agricultural guideline set a cap on annual agricultural expenditure and is determined by the European Commission for every financial year on presentation of the budget draft. Agenda 2000 sets this cap at 74% of the rise in GDP.

According to the DIW, the additional cost of EU enlargement for the European Agricultural Guidance and Guarantee Fund for agriculture (EAGGF guarantee)<sup>1)</sup> will run to between EUR 10.9 billion (reform passed; EU-27: EUR 48.6 billion) and EUR 15.7 billion (no reform passed; EU-27: EUR 57.6 billion).<sup>2)</sup> Dresdner Bank estimates the additional allocations required for 2005 at EUR 13.7 billion (EU-25: EUR 58.1 billion). Both studies underline the need for reform.

In their assessment of Agenda 2000, Ferrer and Emerson (2000) conclude that in the negotiations on Agenda 2000, the interests of net payers and own national interests were pushed through at the expense of the original ambitions, namely preparing the EU for enlargement and for the next round of WTO negotiations, which ultimately hampered a real reform of the CAP. As a consequence, the conflict about EU budget appropriations – at the heart of which is the CAP – has intensified. Therefore it is indispensable, the authors emphasize, to reform the CAP quickly – before enlargement.

Conversely, Lukas and Pöschl (2000) consider an immediate integration of the accession countries into the CAP viable, as EU Commissioner Franz Fischler proposed in March 2000, because on the one hand, the control mechanisms take effect instantly, and on the other, because the acceding countries must fulfill specified health and environmental conditions before fully liberalizing their markets. These nontariff barriers will make it necessary to introduce transition periods for the applicants. Ultimately, this means that the EU will control agricultural production in, and the outflow of agricultural products from, the new Member States, which means that any price wars would be headed off. The extent of direct payments to the new member countries is the key to a rapid and comparatively smooth adjustment.

### 7.3 Effects on Austria

The Eastern enlargement of the EU will have various effects on the Austrian budget, some of which cancel each other out. According to Nitsche (2001b), higher exports and stronger economic growth will produce revenues on the order of 0.4% of GDP. At the same time, the liberalization of imports of tobacco products could dampen indirect tax revenues by 0.2% to 0.3% of GDP. The net effect for the Austrian budget would be slightly positive, with additional revenues running to 0.1% of GDP. As the EU plans to raise the minimum tax on tobacco products, the drop in related revenues could be much lower than projected now. In this case, enlargement would have a more clearly positive net impact on Austria's budget.

Austria's net contribution to the EU budget could, however, deteriorate by up to 0.3% of GDP in the medium term, according to a working group of EU finance ministries (Nitsche, 2001a). This estimate is based on the assumption

1 The EAGGF guarantee consists of market policy (intervention prices, quotas), direct payments and the financing of the CAP's "second pillar" (which comprises expenditure for rural development and accompanying measures, such as early retirement, equalization payments for less-favored areas and the like).

2 The total cost of the internal policies amounts to 0.06% of EU-27 GDP (reform passed: EUR 5.6 billion; no reform passed: EUR 6.4 billion).

that 12 accession countries join the EU and that they are fully integrated into the CAP.

According to the expenditure profile of the European Commission's proposal (2002), the Austrian share (2.2%) of the EU budget (EU-25) would have to expand by an additional EUR 670 million, approximately, for the period from 2004 to 2006 (not including the reduction of the preaccession assistance after entry into the EU). The upper limits set in Agenda 2000 (1999) will not be reached. The Austrian contribution will be EUR 90 million lower in the period from 2004 to 2006 than the amount specified at the Berlin Summit (Agenda 2000: additional Austrian expenditure pegged at EUR 760 million).

Austria's main agricultural interests in the accession talks are to retain national quotas and reference quantities (grain, sugar, milk, beef) under the compulsory land set-aside scheme and the existing intervention mechanisms (grain, milk, beef). It is absolutely necessary that the countries fully adopt EU standards and effective controls in the domains veterinary medicine, hygiene, health protection, product quality, environmental protection and animal welfare.

According to Lukas and Pöschl (2000), complete liberalization in agriculture would entail considerable difficulties for the new entrants, but would be a great boon to the current EU members, above all neighboring countries such as Austria. The enlargement offers enormous opportunities for investment, the transfer of know-how and a greater market presence above all for Austria's food industry and its suppliers.

According to Schneider (2001), imports will expand once markets are opened up to new Member States from Central and Eastern Europe. At the same time, the enlargement will give domestic producers new sales opportunities, which, however, will be of short duration. In the long run, the similar agricultural conditions of the neighboring accession countries will prove to be a disadvantage for Austria.

Unlike the primary production sector, states Schneider, the Austrian food industry can expect the benefits of enlargement to outweigh the disadvantages. Unrestricted access to lower-priced agricultural raw materials and the demand for high-quality processed foods could have a positive impact. However, an asynchronous opening of markets resulting from transition periods could lead to competitive distortions. Schneider concludes that with today's information, the disadvantages and risks of enlargement will outweigh the advantages and opportunities for all Austrian provinces.

To sum it up, all estimates of the budgetary costs of EU enlargement assume that the costs will be lower than 1/2% of GDP for Austria.

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