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Introduction and overview: The EU's "Northern" enlargement 25 years on – stocktaking and some thoughts for the future

Synthesizing main findings from this volume, this article identifies how the three EU Northern enlargement countries have been contributing to the EU's evolution. EU membership has brought substantial economic benefits for all three countries. While these benefits far outweigh financial costs, this is as such no rationale for net financial contributions, as the EU is a win-win situation for all Member States. While a "multi-speed-Europe" seems a pragmatic way to pursue EU integration, if each country follows an "individual utility approach to EU integration", then externalities and network effects are neglected. The EU policy process needs more ex ante and ex post scientific evaluation of policies. Policy benchmarking should be adopted explicitly with the aim of mutual learning, improvement and reform. COVID-19 appears to propel EU integration and EMU deepening. The question arises, though, whether crisis-induced "forced" integration is sustainable. It is crucial that the EU and its Member States will effectively turn the crisis recovery into a catalyst for transformation towards a greener and digital economy and to resist the temptation just to cover up the economic fallout from the pandemic, rather than embarking on transformative structural adjustment.

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2020 marks the 25th anniversary of the EU's fourth enlargement round – sometimes referred to as "Northern" enlargement – which, after several years of negotiations, made Austria, Finland and Sweden EU members on January 1, 1995. For a European country, there is hardly any other foreign or economic policy move conceivable in the second half of the 20th century (and in the 21st) that could be more far-reaching and important than EU membership. It is thus worth looking back on what EU membership has entailed for the three countries.

To study this question, the OeNB, in cooperation with SUERF – The European Money and Finance Forum, has compiled this volume. Originally, this publication would have been the outcome of a conference in Vienna planned for May 2020 as a collaboration between the Bank of Finland, Norges Bank, Sveriges Riksbank, SUERF and the OeNB. Unfortunately, due to COVID-19, this conference had to be cancelled. A streamlined virtual edition of the event took place on September 21, 2020, giving the authors of this volume the opportunity to present and discuss their findings.

Several of the articles in this volume adopt a comparative perspective, reviewing various aspects of EU membership for the three countries in question, while, in some cases also comparing these aspects with other countries. Drawing on these analyses, this introduction aims to flesh out a few general points, which may also be of relevance for the future development of European integration, and comment on the role of the three countries of the EU's 1995 Northern enlargement round.

1 Economic benefits from EU membership have been substantial for Austria, Finland and Sweden

Two studies in this volume (*Anttonen and Vihriälä,* chapter 3*; Breuss,* chapter 4) document, based on the authors' own empirical estimates and the existing empirical literature, that the economic benefits from EU membership have been substantial for all three countries in question, with cumulated increases in real GDP or per-capita GDP ranging from 5% to 10% over the past 25 years.

Most studies find that Austria benefited by far the most among the three countries, offering two possible reasons: First, Austria had to adapt its economic governance and institutions the most (competition policy, liberalization of services and network industries, public procurement etc. – see *Handler,* chapter 11) and thus reaped the largest benefits from increased competition and efficiency gains. Second, Austria profited the most from the EU's Eastern enlargement (see *Breuss*, chapter 4).

These consistent results pointing to large economic gains from EU membership are all the more interesting given the quite different starting points of the three countries: While Austria entered the EU in fairly good economic shape with a large budget deficit, Finland and Sweden were still suffering from their financial crises (see *Anttonen* and *Vihriälä*, chapter 3; *Breuss,* chapter 4*; Handler,* chapter 11).

It is also worth noting that euro area membership does not seem to have made such a big difference. *Breuss,* chapter 4, finds that euro area membership accounted for just 0.1 percentage point of Austria's annual EU membership growth dividend of 0.8 percentage point (0.4 percentage point from single market effects and 0.3 percentage point from the EU's Eastern enlargement). At the same time, it is worth noting that, in effect, the ECB's and the Sveriges Riksbank's monetary policies are not very different in terms of the primacy of price stability in the sense of a low inflation aim that is pursued by an independent central bank.

What is more, many economic benefits from EU and euro area membership cannot be easily conceptualized and quantified. For instance, it is an open question how much Austria' EU and euro area membership helped the country in averting a financial crisis from its bank exposure in Central, Eastern and Southeastern Europe (CESEE) during the global financial crisis (GFC). For lack of a suitable counterfactual this will never be known.

2 Substantial benefits put net financial contributions to the EU budget into perspective

While positive economic effects are model-based estimates or hardly quantifiable at all, the financial flows resulting from the EU budget and other EU programs can be pinned down quantitatively and therefore have gained more public attention.

An argument often put forward by critics of EU membership in wealthy countries is that their countries are net contributors to the EU budget. Indeed, there is no denying that payments by Austria, Finland and Sweden have mostly exceeded funds received from the EU through various mechanisms over time (with the exception of Finland's contributions during its first years of EU membership) – see *Köhler-Töglhofer* and *Reiss*, chapter 10. Against this background, it is not surprising that all three countries of the EU's Northern enlargement round were among the "frugal five" (which furthermore included the Netherlands and Denmark) during the summer 2020 negotiations on the EU's new Multiannual Financing Framework (MFF) and the temporary COVID-19 EU recovery fund (Next Generation EU – NGEU).

While recognizing the importance of funding a substantial recovery investment budget, the three countries share an attitude of fiscal caution, which includes careful use of taxpayers' money (in their home countries but also generally) and strict governance of spending. (For an overview of the three countries' fiscal positions since EU accession, see *Handler*, chapter 11.) In this view, large EU spending and transfers between countries thus need to be accompanied by transparent governance of spending programs and by effective incentives ensuring that spending is used for programs which effectively promote needed structural adjustments during the post-COVID-19 recovery. Moreover, cutting-edge evaluation methodologies are needed to assess whether the program objectives have been achieved. The latter are largely missing and are crucial looking forward.

It should be recalled in this context that, despite tough negotiations in July 2020, which resulted in some concessions as compared to the original proposals by the European Commission and EU Presidency, the EU's new MFF (EUR 1,074.3 billion in constant 2018 prices) in combination with the transfers and loans of the new debt-financed NGEU recovery instrument (EUR 750 billion), will further increase the three countries' net payers' position. The U.K.'s EU exit adds to net payers' contribution (given that the U.K. was a net contributor). From this perspective, the adjective "frugal" should rather be replaced with "ready to generously invest in Europe's future, but financially careful and responsible."

An argument frequently put forward by advocates of very large and lenient EU spending programs is that the net contributor countries reap benefits from EU membership (single market access, participation in the euro area, stronger joint negotiation position on an international level etc.); thus, their net contributions are in a way a "fee" for these economic (and other) advantages from EU membership. This argument is, however, by itself not a reason to justify these payments, since the benefits from EU membership in principle accrue to all EU countries – the EU is a win-win scheme. A priori, there is thus no reason why some countries should pay for these advantages and others receive funds in return. This would only seem justified if the benefits from EU membership for some countries were proven to be gained at the cost of other countries. If, even in a win-win situation, some countries gain comparatively more than others, one should still, before calling for transfers, raise the question why this is the case and how those that may so far have gained comparatively less might, through structural adjustments in their economies, benefit more from the growth-enhancing properties of the EU's single market, single currency, frameworks for sound fiscal policies etc. Only once this analysis has been made, should one identify possible useful financial support to facilitate the needed structural adjustments.

3 The EU as a federation of states, membership in which is useful for each individual state

Sometimes, discourse about European integration is couched in terms of the creation of a "European family," in which solidarity should be a guiding principle. We do recognize the beauty and appeal of this idea, and indeed there seems to be something like "European values" if one juxtaposes Europe with other parts of the world, where democracy, human rights, social systems and protection of the environment are held in much lower regard than in Europe. At the same time, building the EU's integration process on an overly idealistic approach seems of limited promise, given that solidarity sometimes not even works well within individual nations, finding its limits in the preparedness to give and the incentives to freeride and abuse.

The EU's Northern enlargement implied that a group of small countries with highly developed economies, clearly above-EU-average GDP, high wage and social security levels, and a tradition of a "(European) integration at arm's length" attitude joined the "EU club." The EU's Northern enlargement thus affected the balance of preferences with respect to the EU's further integration strategy. This effect was later further accentuated by the accession of CESEE countries, several of which – for different reasons – regard interference from Brussels or any outside countries with skepticism.

Before joining the EU, Austria, Finland and Sweden all had been part of EFTA, the European Free Trade Association, an alternative model of European integration, which aimed at a more limited form of integration focusing mainly on trade cooperation. In the end, the EU prevailed over EFTA, and the Northern enlargement countries basically saw little alternative to joining the EU in order not to be left behind.

The EU's Northern enlargement also implied that the "Scandinavian group" within the EU was considerably expanded, now including Denmark, Finland and Sweden. The Scandinavian countries have a long tradition of close cooperation, which has also continued in recent years, despite Norway in the end staying outside the EU (see e.g. *Farelius, Ingves and Jonsson*, chapter 8, on financial integration and cooperation in the Nordic-Baltic area). The Scandinavian countries also share a tradition of democracies which emphasize the accountability of national governments and state institutions toward their citizens. For these democracies, delegating far-reaching competences and powers to "EU bureaucracies" and not directly elected decision-making bodies, such as the EU Council, is at odds with their understanding of how democracies should function. The fact that both Denmark and Sweden have actively chosen not to participate in the euro fits into this picture.

From the perspective of the Northern enlargement countries, it may thus seem more useful, pragmatic and indeed appropriate to build the EU's integration on the aim to create net benefits for each and every of its participating states. In this approach, the EU is a coalition of interests. Further steps of integration are supported by individual Member States, as long as they are – not only, but also – in the interest of individual Member States.

Farelius, Ingves and Jonsson's account of the careful analysis conducted in Sweden of the pros and cons of Sweden joining the European banking union is instructive in this context. The authors recognize the benefits of the international coordination of financial stability policies in a world of integrated financial systems, while at the same time taking account of the costs of harmonization and cooperation if financial systems are heterogeneous across countries. The decision whether or not to join the banking union then is the result of a cost-benefit analysis at the national level. The authors also take account of a more political argument that Sweden might be further "marginalized" if the country, which already abstained from joining the euro area, furthermore, stayed outside the banking union. In this view, integration could thus proceed based on all Member States pursuing their own cost-benefit analyses and their own interests.

It is obvious that what counts in the end is the perception of costs and benefits and of usefulness by policymakers and the public. The importance of perceived usefulness is also reflected in public opinion on the euro and the ECB. In this context, the analysis by *Roth and Jonung*, chapter 6, provides interesting findings. They show, first, that support for the euro during the GFC and the European sovereign debt crisis remained high in the two euro area countries

Austria and Finland, while the sovereign debt crisis significantly diminished support for Sweden joining the euro. Second, support for the ECB hinges crucially not so much on inflation performance, but on the development of unemployment in the euro area. While this may be viewed as consistent with the short-term demand-side effects of monetary policy on output and employment, it is at the same time at odds with the allocation of responsibilities and economic goals among branches of government. It may simply reflect the fact that the ECB and the euro so far remain the major symbols of European (economic) integration, and whatever happens in the economy is therefore reflected in attitudes toward the ECB and the euro.

4 But: the individual utility approach to integration may also have important shortcomings

There are, however, important counterarguments against an individual utility approach to integration. First, it neglects externalities of individual countries' choices. While, for instance, staying outside the European banking union may indeed be more advantageous for an individual country, this choice may imply negative externalities for its neighboring countries, which may indeed be part of the euro area and whose banking systems may be affected by the decision on joining the banking union. What decision-making in the EU should achieve, is to put such externalities on the table in the decision-making process for the EU's integration strategy, so that they can be incorporated into decisions.

A second argument is that, indeed, there may be integration steps which are clearly in the interest of the EU as a whole, but which unambiguously go against the interests of one or several member countries. In this case, unanimity requirements may block important, and on the whole beneficial, integration steps. To solve such gridlock situations, the standard solution for economists are compensation payments, in political practitioners' language: package deals and EU transfers. And indeed, this is how many EU negotiation situations and decisions can be interpreted.

Emphasizing the pursuit of individual Member States' interests may also be viewed to be at odds with the fact that the individual EU country level is not necessarily best suited to solve problems. The size of individual EU Member States varies at a factor of 1 to 275 (nominal GDP, Malta versus Germany in 2018) or 1 to 166 (UN population estimate for 2019, Malta versus Germany). Several German federal states are larger by any measure than any of the three Northern enlargement countries. Many of today's pressing problems require global solutions: COVID-19, climate change, a fair and nondistortionary international trade order, etc.; this has led Angela Merkel to predict: "*The nation state on its own has no future*." (video press conference with Emanuel Macron of May 18, 2020, quoted in *James*, chapter 2). Other problems can and should better be solved at the level of local communities and cities. This leads *James* to conclude that "*old-style nation-states are having to rethink where, and how, they stand in the world*."

5 A major strength of the EU lies in its diversity, which emphasizes the benefits from the international division of labor and facilitates mutual learning

Many observers and critics of the EU project point out the heterogeneities among EU countries. They emphasize differences in technological development, the functioning of state institutions, social security systems, per capita GDP, education systems etc. Within the euro area, the differences across countries are sometimes interpreted as proof that Economic and Monetary Union (EMU) does not satisfy the criteria of an optimal currency area, thus causing recurrent phases of instability and requiring temporary or even permanent transfers across countries. Cultures and preferences across EU Member States are pointed out to differ substantially, thus making agreement on policy priorities and joint economic policy philosophies difficult and often unsatisfactory.

However, there are many counterarguments. A central pillar of the EU is its single market. One main benefit of international trade in goods and services, but also in labor, rests on comparative advantage. Thus, diversity of production structures should increase the benefits from the EU single market and EU membership.

At an institutional level, the different EU Member States can learn from each other. When studying various aspects of economic systems and policies, the differences between countries are striking. When it comes to taxes, social systems, education systems, health systems etc., there are no two countries whose systems are alike. There may be good reasons for this (preferences, history dependence etc.) – or not. Many of these differences may be arbitrary and accidental but should by all means be questioned in the quest for optimal policies. So, it is worth for any country's government to look at what others are doing and learn from it, and to maybe get one or the other good idea from peers.

All policy coordination in the EU – be it with a more or less binding character – contributes toward this aim. In a sense, the EU can be viewed as a huge mutual learning project for governments and public servants. All countries experienced the same EU membership-induced push toward opening up and an internationalization of perspectives in all areas of government, business and attitudes. What is more, this mutual learning process goes well beyond the level of government and state institutions, and encompasses most areas of business, work, education and life in general.

Preferences and institutions are ultimately not set in stone. Societies may learn and adapt, and institutions can improve over time. The EU is a useful framework to also encourage improvement in state and economic institutions. Various aspects of the EU's structural reform agenda, the EU's competition law (which is quite stringent by international standards) and the dynamics of the internal market in general force governments to pursue reforms which, outside the EU, they might not have the courage to tackle. Austria is a case in point, as *Handler*, in chapter 11, points out in detail for competition policy, public procurement, network industries, but also fiscal policy.

This is no guarantee that reforms proceed as well as they should in all EU countries and that inefficiencies and even corruption are automatically a thing of the past once a country joins the EU. But the EU at least provides strong incentives and the necessary awareness and knowledge base through peer learning to improve institutions and structures in its Member States.

The three Northern enlargement countries had – and continue to have – a lot to offer in this respect. For instance, Sweden has a long history of state transparency and scientifically based policy evaluation. Sweden has also shown how to scale back one of the largest tax rates in the world to moderate levels without causing social upheaval. Austria has a successful and beneficial tradition of cooperation among social partners. It has shown how an inefficient state industry can successfully be transformed into internationally competitive and profitable private firms (see *Handler,* chapter 11). Finland has a rich experience in dealing with substantial shocks (e.g. the breakdown of the Soviet Union, or the rise and fall of Nokia and the paper industry – see *Obstbaum* and *Välimäki,* chapter 7). The two Nordic countries also offered important lessons for other countries during the GFC, having already shown how to deal with similar crises during financial booms and busts in the late 1980s and early 1990s. In a similar vein, Austria showed how to cope with headwinds faced by its large internationally active banks in the GFC, without abandoning the CESEE markets abruptly and to the detriment of CESEE countries (Vienna Initiative).

In turn, the three countries certainly benefited from the vigorous push toward an internationalization and opening-up of their countries, both economically but also in terms of science, culture and overall attitudes. EU membership forced them to revamp and modernize their economic institutions and to liberalize many areas of their economies (more so in Austria than in Sweden and Finland – see *Handler*, chapter 11).

As *James*, chapter 2, puts it: Crises like COVID-19 "*require highly competent governments*." If cooperation within the EU manages to improve mutual learning among governments, both the European project and EU citizens benefit.

6 "Failing forward" versus principles-centered European integration, and variable geometry

James, chapter 2, recalls the political science concept of "failing forward" as the main driving force of European integration and institution building, which is akin to Jean Monnet's famous quote that "*Europe is driven by crises*." James questions whether this is a sufficient foundation for the European project and sees a "*need for a countervailing motivation, emphasizing fundamental values rather than a technocratic fix*." Let's call this latter approach to European integration "value-driven" or "principles-centered" integration.

Two remarks seem useful in this context. First, the observation that crises are important triggers for reform (economic and other) is not peculiar to European integration. It applies to individual countries in much the same way as it does to world politics and to personal lives. Big reform steps involve big costs and efforts, which tend to be avoided or delayed if not absolutely necessary and pressing. Given the many players and interests involved in European politics, it may be more difficult to reach agreement, and thus the importance of crisis triggers may be more important than at the national level. But one could also argue that the supranational nature of EU decision-making makes certain decisions easier than at the national level. Indeed, many laws in the areas of safety, environmental and consumer protection, but also rules for fiscal responsibility and monetary stability, seem to be more easily achievable at the European than at the national level. Once far-reaching EU legislation has been decided at the EU level, national politicians no longer (or to a much lesser extent) face the need to justify measures to their national electorate.

Second, the process of crisis-driven change demonstrates useful flexibility to adjust to changing circumstances, requirements and maybe societal preferences over time, which any state and indeed also the EU should have. Take the example of EU banking regulation and supervision since the Northern enlargement. As *Kaden*, *Boss* and *Schwaiger*, chapter 9, show, financial regulation and supervision adjusted its goals and tools several times over the past 25 years to reflect changing environments, requirements and shifting political and societal preferences. This flexibility is no sign of a lack of fundamental vision or of technocrats ruling the system, it is simply the appropriate way for political and economic systems to react to changing circumstances and new insights.

In the end, the EU's and any individual state's approach to development and reform is a combination of values and principles and reactions to changing circumstances, preferences and, in the extreme, crises. National constitutions find their counterpart in the EU Treaty and the Charter of Fundamental Rights of the European Union – both types of texts reflect fundamental values and principles. Within these frameworks, nation states and the European Union may develop and, if far-reaching changes are required, for instance – but not only – in response to crises, even adapt certain aspects of their constitutional structures.

Given EU Member States' quite different starting points, mentalities, societal and economic preferences, history and political cultures and traditions, it may in fact seem quite surprising how much integration actually has already been achieved and how boldly European integration continues to proceed (as evidenced by the recent political agreement on the MFF and Next Generation Europe). One approach which the EU has adopted over the decades is to sometimes allow individual countries to take certain steps at different speeds or to even opt out of them. The adoption of the euro and participation in the Schengen Agreement are obvious examples. This "multi-speed" or "variable geometry" approach is thus a useful and established, pragmatic way to achieve progress in European integration as the need and desire arises, while not neglecting some EU members' reservations against certain integration steps.

Another development which has come to the fore with the EU's Northern and Eastern enlargement rounds, and also most recently, is that smaller countries form coalitions or subgroupings within (and beyond) the EU. The Scandinavian-Baltic cooperation in the field of financial regulation and supervision mentioned above is just one of many fields in which the Nordic countries form a "subgroup" in the EU, which also extends beyond the EU by including Norway and Iceland. Among CESEE countries, a coalition among the Visegrad countries has gained visibility over the past years. Most recently, the ad-hoc coalition of five small "Northern" countries including Austria, Denmark, Finland, the Netherlands and Sweden gained much attention in the negotiations on the MMF and Next Generation Europe recovery package. Such groupings may be eyed somewhat skeptically by other EU countries. But they may also be read as a reaction to smaller countries' perception that their voices are not sufficiently heard in EU negotiations, which seem – in their perception – to be dominated by the large EU countries and led by Germany and France. The example of Brexit could be interpreted as a lesson that also in wealthy countries, public support for the EU needs to be carefully nurtured and maintained, not only by governments in these countries, but also at the level of the EU by carefully pacing the speed and intensity of the EU integration process and keeping a watchful eye on its financial implications.

7 Challenges ahead can be addressed more effectively together in the EU

The next years will bring formidable challenges for European countries and the EU. In the short term, overcoming the COVID-19 pandemic and responding to its economic consequences will take center stage. Leaving medical issues aside, economic responses include both mitigating negative effects on firms and workers in the shorter term and embarking on necessary structural adjustments resulting from permanent COVID-19-triggered consequences. Both the Eurosystem and the EU body politic have taken bold steps to address both aspects. As short-term demand-oriented measures are easier and more popular, particular attention will need to be paid to the long-term structural measures needed.

This links with required action for climate protection. Climate action is a typical area where individual small countries can achieve little alone and acting together in the EU is essential. The EU as a grouping of – in a global comparison – rich and technologically advanced countries must take the lead in climate action. This could create powerful synergies with the post-COVID-19 recovery strategy. By being proactive, Europe can also gain a competitive edge – so far it has not shown sufficiently convincing action and progress in this area. The European Green Deal is a bold and visionary program which now needs to be filled with life.

A major global challenge which has already been affecting Europe, and will continue to do so, is global population growth. Population growth in developing countries is a major impediment to development. It also further diminishes climate sustainability, particularly if the aim is to lift living and consumption standards in these countries. Ultimately, the combination of these factors may increase immigration pressure on Europe. As the experience since 2015 has highlighted, the EU finds it hard to deal with this challenge effectively and without causing major disruptions among EU Member States. At the same time, non-European countries such as China, are seizing the opportunity to secure their economic and political influence in Africa and other regions. The EU should, both in its own and in the interest of the countries in developing countries, adopt a more proactive and comprehensive approach to development and neighborhood policy.

The next years and decades will also bring secular changes in production structures, work and consumption patterns, due to digitalization. Digitalization raises fundamental questions regarding the organization and allocation of work, and the mechanisms governing the allocation of income from production, as *Warhurst* and *Dhondt*, chapter 5, point out. Digitalization often requires big concerted research effort and favors large firms due to extensive scalability. In central areas of digitalization, Europe is not in the lead or is about to lose a leading role. Individual Member States have every interest to support and contribute to the advancement of the European Digital Strategy. Again, particularly for small, developed, high-wage countries such as the three Northern enlargement countries, participating in a joint EU digitalization strategy is helpful in many ways (being part of transnational research projects, larger firm size due to European-wide operation, European power in the setting of technical standards etc.).

Being part of the EU puts Austria, Finland and Sweden – and indeed all EU countries – in a better position to convert these challenges into opportunities. To appreciate this, it is useful to abstract from differences in opinion on various detailed measures and aspects of the EU and its ongoing integration process in the short term, and to keep the bigger picture in mind. After all, the diverse skills, approaches, views and preferences of its members are the EU's major asset. No member country should thus shy away from articulating its views and preferences. It is the culture of listening and negotiation which brings this diversity to a fruitful result. The three countries of the EU's Northern enlargement round certainly have important contributions to make in shaping the EU's future course.