The Agenda 2000 and the EU Membership of CECs

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The paper expresses the view that EU enlargement towards East can take place in the next decade, as opposite to the majority view in favour of a more gradual process. Further analysed are main macroeconomic indicators such as GDP, inflation rates and per capita GDP for Greece, Portugal, Spain and a selected number of Central European and Baltic countries. Particular emphases are placed on the comparative differences in the economic performance using the 1997-8 data on main macroeconomic indicators for the selected countries. In the comparative perspective, individual countries are ranked with respect to Germany, as a country with leading role in the EU monetary policy. The results indicate that shorter integration process should be preferred. Most of the analysed CEC's are similar in their economic performance, with the exception of Slovenia which ranks above Greece and Czech Republic which is found to have a more closed economy then the rest of the region.

Key words: **Agenda 2000, CECs**

The European Council met in Berlin on March 24th-25th and will meet in Köln on June 3rd-4th 1999 to discuss the enlargement of the European Union (EU) towards East (particularly at the Berlin meeting). These meetings follow the publication of "Agenda 2000", July 1997, the official document of the European Commission setting the strategies and guidelines for making the EU look towards East.

Ten of the Central European countries (CECs), together with Cyprus and Turkey, are interested in such meetings because the timing of accession and the rules of the "game" are established there. At the same time, a new framework for common budget policy has to be found in an effort to rationalise both national contributions to the EU's budget and the expensive disbursements towards the common agricultural policy (about 50% of the EU's budget) and structural fund cost. In this respect, many authors have estimated the budgetary effects of CECs admission to the EU. The total cost of the EU's budget ranges from 25 to 30 billion ECU, but considering the contribution of these countries to the EU's budget, the total net cost will be between 20 and 25 billion ECU[2].

In this brief paper, we aim to consider the recent economic outcomes of transition economies and explain why we favour the EU enlargement policy in the first part of the next decade, and not much later as favoured by other economists. After this introduction, we overview the economic issues of CECs integration to the EU. The text advances a simple approach to enlighten the economic convergence in Europe and to provide data on GDP items, inflation rates and per capita GDP of Greece, Portugal, Spain and selected CECs and the Baltic in the way advanced first by Sergi (1996). This "exercise" ranks 10 economies versus Germany, in our assumption the leading country in conducting monetary policy in Europe.

An overview of CECs

On the whole, CECs are similar when looking at some economic data, but do differ in others. The slow reforming countries such as Bulgaria and Romania show the greatest differences mainly in the agricultural sector. Despite inflation, it is not always possible to compare the components of GDP among western countries already forming the EU. The differences are negligible and indeed sometimes in favour of selected transition countries when the service sector analysis is applied.

In 1995, the average candidate country generated 8.7 percent of its total gross value (agriculture added), compared to the EU's average (2.3 percent). Bulgaria (15.4 percent) and Romania (20.7 percent) show the highest figures. The EU's highest is Greece (14.2 percent). In the EU the services account to 66.5 percent of gross value-added, compared to the East (53.8 percent). The East lowest is Romania with 37.9 percent. Poland (52.7 percent) is the only other lower than the EU's lowest (Ireland, 53.2 percent). The EU highest with 75.3 percent is Luxembourg.

In perspective, a positive trend may arise form the private sector that amounts to more than 60 percent of both GDP and in turn it may be of benefit to labour market. Bulgaria and Romania have small private sector in GDP (their private sector accounts to less than 50 percent of GDP) though the share in GDP is likely to accelerate because new privatisation and deeper restructuring programs are expected to be implemented soon. Another side of this story is that the ratio of the shadow economy could reach up to 25-30 percent of the CEC's GDP and even higher in former Russian Federation countries[3]. It is evident that estimates yield striking discrepancies according to different techniques used. Even relying on the lowest estimates should these figures be included in the official GDP, the economic structure in the transition economies could come closer to the West's, especially in the Czech Republic, Hungary, Poland and Slovenia.

As GDP growth is concerned, transition economies continue enjoying economic growth that is high in Estonia, Hungary, Lithuania, Poland and Slovakia (see table 1). The estimates for 1997 place CECs and the Baltic on the higher scale of GDP growth than the EU and it is expected that such a divergent economic growth will continue in the region throughout the 1990s. To give statistical figures, the countries that candidate for accession to the EU have since 1993 shown a positive real GDP growth being constantly high and well above the EU average[4].

The real per capita GDP in 1997 (see table 1), in CECs was 40% of the EU average, rising from 38% in 1995. Slovenia had 68% of the EU average followed by the Czech Republic with 63% of the EU average, Hungary and the Slovak Republic both with 47%. Greece and Portugal had the EU's lowest per capita GDP, 69% and 71% respectively. Bulgaria recorded 23% of the EU average, the lowest CECs figure. This contrasted with Luxembourg, Denmark and Belgium, 66%, 15% and 13% respectively above the EU average and more than seven and five times respectively the Bulgarian figure.

Average inflation rates during 1990-94 were 4.3 percent in the West and 107.7 percent in the East. Inflation has eased in either parts of Europe and the downward trend is expected to continue throughout the end of the century. The 1998 has witnessed the

Table 1. Basic economic data

	GDP growth (1997)	Inflation (June 1997 - June 1998)	Unemployment (% June 1998)	Real 1997 GDP (1989=100)	Per capita GDP 1997 (UE=100)
Bulgaria	-6.9	18.8	11.4	66.6	23
Czech Republic	1.0	12.0	5.6	97.5	63
Estonia	11.4	10.2	4.3	77.1	37
Hungary	4.4	14.2	9.1	90.4	47
Latvia	6.5	6.1	7.2	56.2	27
Lithuania	6.1	6.1	5.5	62.3	30
Poland	6.9	12.1	9.6	111.8	40
Romania	-6.6	55.3	8.8	82.3	31
Slovak Republic	6.5	7.5	13.5	95.6	47
Slovenia	3.8	8.3	14.1	95.5	68

Sources:
(*) UN/ECE: "Economic Survey of Europe", 1998 No. 3.
(**) Eurostat news release, No. 68/98.

low inflation (see table 1) contributed by the labour costs and the reduction of import prices. On average, the inflation rate is below 10 percent. Extremely important results are that of Bulgaria (from 1082 percent in 1997 to 0,3 percent on a monthly basis in mid 1998), of Romania (from 154.9 percent in 1997 to a target of 25 percent fixed in 1999), the countries which have selected CSI economies. Therefore, we believe that in the light of recent outcomes in the economic performance it is likely that GDP will continue to grow within the framework of stable prices.

Even if the inflation "gap", partially due to different monetary strategies as shown above, is sometimes sensible, there are strong reasons for making two considerations. First, in the process of deep market reforms it is possible that even in the light of western monetary style, monetary policies cost-push factors may cause inflation sometimes in the future (especially the economies which have to complete the microeconomic reforms[5]), and beyond the rates compatible with western monetary policy strategy. Second, and in addition to cost-push factors, the consumer price index overstates the rate of inflation in the transition scenario. The explanation of that is the better quality in new goods and services from recent productions that goes partially or totally unmeasured in the traditional consumer price index. A truer cost of living index would take in account the consumer surplus prices rising more slowly.

The convergence process

This section inquires the feasibility of integrating east and west sides of Europe into a common area and compares their economic structures (see Sergi, 1996a and 1998b, for more detailed explanations on the rationale of this type of analysis).

Besides the implications arising from competition and the conduct of economic policies, the paper confronts with the fact that such a "joining" may imply either a political union where domestic policies are independently set or a single-currency union where monetary policy is designed by a common monetary authority. While the first type union represents the first stage of the European enlargement to the East, it does depend on the budgetary effects of CECs admission to the EU, the single-currency union would be the second stage, and the Maastricht Treaty's convergence criteria will, no doubt, be applicable. In fact, the above issues became main arguments for debate when becoming a member of the EU, as it is set at the Copenhagen European Council in June 1993 (stability of institutions guaranteeing democracy, functioning of market economy, ability to take on the obligations of political, economic and monetary union).

There are two noteworthy points. First, this "exercise" on inflation rate and service sector as a percentage of GDP ranks 10 economies versus Germany that we assume is the leading country in the conduct of monetary policy in Europe. To rank countries in this way is an advantage, because it permits making comparative analysis based on one of the GDP components and facilitates our efforts in answering the question posed in the introduction. The use of per-capita income or the deviation of unemployment from its natural rate is the more inconvenient of the two alternative feasible options that might illustrate whether the West enlargement to the East is a feasible option.

Second, the importance of ranking countries into homogenous groups enables us to see whether countries produce similar economic performance, and whether the use of the convergence of the economy's structure looks reasonable, at least when considering that our work is the first effort of this kind[6].

We use some data on economic structures and inflation rates of Greece, Portugal Spain and selected CEC's and Estonia. The choice of our samples was determined by availability of data for these countries. We recognised that different data would alter some of the findings. (Early drafts of this paper report that Germany's inflation was the lowest in Europe before 1997 and with data referring to 1997 the ranking of CECs is unmodified and such a shift would have little significant changes).

In the economic union of the European type, monetary policy is centralised and fiscal policies are "partially" independent. In case of a broader membership, CECs would then need a clear notion of how this union would work and how would CECs integrate the conclusions into the EU, whether right now or much later. The optimal policy as to whether to carry on an economic union would be that of waiting to see the divergence between the two blocs vanish, though there is no reliable statistical assumption made on the critical value that might be applied to our calculations. The mutt of the matter is that the two aspects stand at either extreme:

* the enlargement to the East will consider taking into account the economy's fundamentals prevailing in less rich West European countries where the level of wealth is more comparable with those of the countries looking for membership;

* a successful membership of Eastern European countries into the EU is only the first aspect of this analysis in short-term period because it would imply a membership into the Euro-zone in the long-term (in the short-term it looks unlikely). So, in the long term, it will be subordinated to greater economic relationship with the neighbouring D-Mark area countries, notably the strongest in Europe.

From the points raised above, the enlargement will be judged according to parameters of less rich EU countries but their successful stay will be subordinated to the comparative position with the D-Mark area countries.

In practice, our benchmark is Germany, and in particular this paper measures the convergence of European economies with respect to Germany's GDP economic structure and its own central bank reputation for low inflation policy. Of course, it is difficult to know how much bias from zero is equally sustainable to create the lasting common area worth pursuing. Should joining occur, even without full convergence taking place, a continuing convergence between the two blocs is advisable. Thus, the larger the divergence in outcomes towards inflation and the fundamentals of their economies, the easier the rejection of joining. As long as there are disturbances that force the CECs away from the "optimal state", the West enlargement to the East is unlikely.

Table 2.
Ranking of selected EU and CECs versus Germany

10 EU and CECs countries vs. Germany	
Spain	0.000017
Portugal	0.000053
Slovenia	0.0051
Greec	0.010
Czech Republic	0.016
Estonia	0.026
Poland	0.062
Hungary	0.080
Romania	7.65
Bulgaria	209

Sources:
Sergi, 1998b.
Notes:
The inflation rates are either 1997 or 1997e for Bulgaria and Romania. Service sector as a percentage of GDP as of 1995.

The estimates of the comparative position of 10 countries with respect to Germany are given in the table 2. The results should be read in this way: the lower the value (e.g., close to zero) the closer the end of convergence path and the easier the joining[7]. Included in the upper rank are Spain, Portugal and Slovenia. Slovenia, Greece, the Czech Republic and Estonia are closely packed[8]. Romania and Bulgaria form the bottom group, and they stand little chance of catching-up in the near-term with the "Mediterranean" EU countries9.

It is worth listing some facts.

(See Table 2.)

First, what matters are not single measures of inflation and the service sector in GDP, but their ratio. It may look unclear why countries are compared in the light of the share of services in GDP, though, it is of consequence to what was argued earlier in the text: (a) the coverage of several countries is adequate for explaining the comparison through the use of the structure of their economies; (b) the final results mainly reflect the "comparative" ratio of the two parameters.

Second, recent data for most CECs show signs of improvement so that their comparative position may look much improved in the short-term and indeed "amplified" if new technologies and skills spill over into these countries and fully adapt themselves to market mechanisms (Welfens, 1997; Black and Moersch, 1997). The position of CECs does not look worse than that of Greece, Portugal and Spain at the time of their adhesion to the EEC in 1980's.

Third, the policy of joining will occur on the basis of bilateral agreements. Our own a priori belief is that high flexibility in joining might be more effective and allow membership in the EU first to best ranking economies. Although there are no fixed dates for the eastward enlargement, and though the year 2002 is seen as the first possible date by the Agenda 2000, Slovenia and the Czech Republic can become members in the next few years, that is in 2002. Countries such as Estonia, Hungary and Poland will hopefully follow in the middle of the next decade, and the others may secure member statues late in the next decade. As for the third group of ranking countries (Romania and Bulgaria), the prospect of their membership seems to have faded, they will take longer to join, in spite of an extraordinary income growth combined with recent signs of lower inflation rates.

Fourth, there is no strong argument for preventing speeding-up the process of membership into the Euro-zone soon after they become EU members. In case of an accelerated enlargement to the East, Greece might still be out of the Euro and the membership into the Euro-zone would rely on common criteria (the criteria set at Maastricht).

* * *

It is possible to consider the collapse of communism, the fall in measured output and the consequent problems in dealing with the proper role of economic policy. Many factors do exist, but only two become crucial to symbolise our point of view and contribute to a new and profound debate. One issue is that CECs policy-makers have keenly supported freeing prices and wages from state involvement, hence adopting rapidly the basic principles of western economies. They moved the economy to restructuring of state enterprises and a more deregulated economy by selling-off programs to let the economy experience faster growth by removing all microeconomics and macroeconomics deficiencies (Sharma, 1997; Welfens, 1997). Efforts may cause job openings, which would fill the gap in jobs inherited from the dismantling of the state involvement. Since we believe that there is no firm evidence on general criteria whether privatisation and reforms must go fast or gradually, policy-makers ought to do all they can to prevent this process from being halted, or even worse, reversed. Thus, it is wrong to say that privatisation and reforms have been inadequate so far: they simply must be done because any transition process needs time (Sergi, 1998a).

The second issue refers to increasing number of economic statistics showing improvements in growth performance (Poland, Slovakia and Slovenia have attained pre-transition real GDP levels) and the concern about the prospects for the conduct of economic policy and for the role of fiscal policy.

Policy-makers and economists have long been "lobbying" for keeping the budget deficit fixed at zero percent of GDP as a simple way to pursue least economic deficiencies. However, this sort of tough fiscal stance is not supported by a serious rationale as to why such a rigorous goal is set up in the literature and the unwillingness of policy-makers to deal judiciously with this argument. This fact is symptomatic of at least misinterpreted economic rule. A new budget proposal aiming to stabilise the dept/GDP ratio offers the guide for possible expansion of fiscal policy and reviews the debate on the provoking role of striving both for maximum and for profitable government deficits without pressure on the debt to GDP ratio (Sergi, 1996b, 1997, 1998a).

Final remarks

We have presented some data on the ratio between inflation and service sectors as the percentage of GDP of 10 European countries and have compared it with that of Germany. Our simple model evaluates the accession of Central and East European countries to the European Union. It is possible to observe that positive structural convergence within these countries has been made, however, further changes in competitiveness are desirable, as they are necessary conditions for the long-run success of a prospective West/East integration. Negotiations with countries aspiring to become new members of the European Union may be finalised by early next century.

Central European countries may "link" with Western European countries in the near future and the process of enlargement will probably take into account the economic conditions prevailing in the less wealthy Western countries and not those of the European Union's income average. By contrast, the importance of having economic fundamentals more in line with Germany is to provide lasting opportunity to compete within broader Euro-zone. The issue of timing is important and the prospects are encouraging.

To conclude, this paper argued three things: (a) the first step of this process may take place relatively soon and this is in contrast with other views that advocate a two-three decades postponement; (b) Slovenia ranks better than Greece and the Czech Republic, and other Central European countries are increasingly similar to western economies which are at the same level of development; (c) there could be a solution to Europe's Euro "dilemma" allowing the entering country to take part in the political and economic union first, then in the currency itself.

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Notes

1. DESAT, University of Messina. This paper is based on Sregi, 1996a and 1998b. I am extremely grateful to the editor of this Journal for having encouraged me to write on this topic.
2. See Koop (1997) for a longer comment.
3. For example, Russia 40 percent, Moldova 40 percent, Ukraine 46 percent, Georgia 64 percent as reported in "Transition", April 1997 p. 6.
4. According to the Eurostat's figures (Eurostat news release, No 68/98), the 10 CECs togheter with Cyprus and the 15 EU countries have grown as follows:

	1993	1994	1995	1996	1997
CECs	1.1	3.8	5.6	4.1	3.6
EU	-0.6	2.9	2.5	1.7	2.6

5. For a microeconomic analysis of the transition process, we refer to Sharma.
6. Of course, further research will be welcome. Gaynor and Karakitsos (1997) use the cluster analysis and distinguish in the EU core, median and periphery countries through their performance in terms of the Maastricht convergence criteria. They wrote that: "members of the EU are not currently producing similar macroeconomc performance" (p. 36). Using data of consumer price inflation, long-term interest rates, deficit and debt figures as of 1994 and assuming three groups, clustering (note that other authors have tried to form homogenous groups of countries) produces some results though the: "cluster analysis is not the most rigorous of statistical methods. In fact, there is no statistical assumption made about the underlying population of cases. Therefore there is no right or wrong way to form groups through cluster analysis. However it is a useful tool for thinking in a structured way about the nature of the similarities between groups of similar members" (p. 35)
7. In Sergi (1996a 1998b), have been defined expected losses of monetary policy strategies made by either the western central bank or autonomously by CECs national banks. To calculate the deviation of CECs from Germany (the western type monetary policy) it was applied the following:

$$\left(\frac{\beta_W}{\alpha_W}-\frac{\beta_E}{\alpha_E}\right)^2>0$$

where beta stands for inflation, alpha for the services sector as a percentage of GDP, the subscript W and E represent the west (Germany) and the east respectively. The outcome will be greater than zero: we assume that the inflation rate in the west is lower than in the east and the resulting negative number in (.) becomes positive because of the squared formula. Therefore, the loss function of submitting to a western monetary policy minimizes when the deviation of the ratio approaches to zero. CECs are better off in a common area only in the circumstance of prior structural converge and under this hypothesis welfare losses decrease and efficiency gains appear.
8. In the Gaynor and Karakitsos (1997) cluster analysis, Greece is the periphery country, Italy, Portugal and Spain are the median countries, and Belgium, Denmark, France, Germany, Ireland, the Netherlands and the UK are the core countries. Their results are quite in line with ours, but differ when looking at Belgium and France, though the methodologies are quite different (Sergi, 1998b). They say: "The overriding message of this analysis is that the difference between Greece and the rest is relatively large for 1994 data. Within the other groups, Denmark, the Netherlands, Germany and Ireland are closely packed. France and the UK form their own group, but very close to the first. Belgium is on her own, but not terribly removed from the rest. Meanwhile, Portugal and Spain are very similar, Italy is closer to these two than the rest, whilst as a group these three are a reasonable distance from the core" (p. 36).
9. In Sergi (1998b), 17 countries were ranked versus Germany and formed three groups. All of the D-Mark area countries were found Germany oriented and hence formed the first group along with the Southern EU countries. Greece is the only exception because it is the only "Mediterranean" EU country classified in the second group together with Slovenia that would have the lead, the Czech Republic, Estonia, surprisingly Russia, Hungary and Poland. Romania and Bulgaria are together in the third group.