Policy Analysis
No. 489 September 18, 2003

EU Enlargement
Costs, Benefits, and Strategies for Central and Eastern European Countries

by Marian L. Tupy

Executive Summary

The accession of eight Central and Eastern European countries (CEECs) to the European Union in 2004 will bring some important benefits. The new members will gain from reduced barriers to trade and investment. By 2010, the movement of labor will also be freed. But accession to the EU is neither a necessary nor a sufficient condition for economic growth. The combined effects of market access and economic liberalization, not EU membership, optimize economic growth.

Unfortunately, the incoming EU members had to choose between the common market on the one hand and economic liberty on the other. Instead of concluding free-trade agreements with the EU, the CEECs were cajoled into an increasingly centralized superstate, in which most of their comparative advantages will be legislated out of existence. As a result, economic growth in Central and Eastern Europe (CEE) will continue to be suboptimal. The loss of potential future economic growth will be only partly offset by the CEEC's access to the European single market.

Following the collapse of communism, the CEECs searched for a quick way to prosperity, and EU accession seemed like a rational step forward. Unfortunately, the geopolitical aim of the European elites to rival the United States enjoys clear precedence over the developmental needs of the CEECs.

Compliance with centralized EU regulations in three areas—labor, agriculture, and the environment—will impose the most significant costs on the CEECs. Western European labor regulations will make many workers in the less-productive CEECs less competitive; agricultural subsidies will favor current EU members over future ones; and stringent environmental regulations will impose a cost of up to 120 billion euros on CEECs.

Accession members should be wary of future EU initiatives, such as harmonization of taxes, which will further reduce their competitiveness. Once the CEECs join the EU, they should pursue a strategy that seeks to introduce economic dynamism to the region by forging an alliance with more economically liberal governments to prevent further centralization in Brussels, working to prevent the adoption of costly welfare entitlements in the new EU constitution, guarding the national veto system within the EU, and working to abolish or substantially reform the unfair Common Agricultural Policy. To the extent that the accession countries can continue to unilaterally liberalize, their economic performance could provide a useful example for other EU countries.

Marian L. Tupy is assistant director of the Project on Global Economic Liberty at the Cato Institute.

Full EU membership comes with considerable costs to optimal economic growth.

Introduction

Pending approvals in national referenda, on May 1, 2004, 10 countries will officially join the European Union. Eight of those are Central and Eastern European countries (CEECs) that were part of the former Communist bloc. They include the Czech and Slovak Republics, Hungary, Poland, Slovenia, Latvia, Lithuania, and Estonia. The EU enlargement will increase the size of the European common market from 370 million to roughly 470 million people. Many of the barriers to trade, investment, and movement of labor will disappear. Exchange of knowledge, technology, and new ideas will become easier. Foreign competition will improve business transparency and corporate accountability. Access to the common market will improve the attractiveness of the CEECs as a destination for foreign investment. Economies of scale will drive down prices and transaction costs. Productivity of capital and labor will increase. Consumer goods will become cheaper, better in quality, and more diverse.

Such are some of the many advantages of joining the European common market. However, unlike Switzerland, Norway, and Iceland, the CEECs were never given the option of joining just the free-trade area. From the start, the EU was prepared to consider the CEECs for only full EU membership.[1] But full EU membership comes with considerable costs to optimal economic growth. Membership will subject the CEECs to 97,000 pages of EU rules and regulations and thus deprive them of many of their comparative advantages.[2]

To be sure, some of those regulations are more ridiculous than economically damaging. Regulation 2257/94, for example, specifies the size and shape of bananas that can be sold in the EU. The regulation limits the size of bananas to at least 14 cm and insists that they should be free of "abnormal curvature." The EU suffered much ridicule as a result of that legislation but did not rescind it. Among other things, it mandates that the legality of bananas be determined "in millimeters, of the thickness of a transverse section of the fruit between the lateral faces and the middle, perpendicularly to the longitudinal axis."[3]

Other legislation is more economically damaging. For example, as a result of the enlargement negotiations, Estonia was forced to introduce 10,794 new tariffs against imports from outside of the EU. Estonia was also forced to adopt a number of nontariff barriers, such as quotas, subsidies, and anti-dumping duties. Unfortunately, such protectionism increases food prices and lowers Estonians' standard of living.[4]

Government expenditures needed to meet the cost of the EU regulations will also necessitate greater debt and higher taxes. According to the *EUobserver*, an English-language daily newspaper in Brussels: "Due to the large expenses involved [in accession, the new members] will have to ask public or private financial institutions for money. Governments may also have to adopt economic measures, such as increasing taxes, to finance EU law implementation." Compliance with the EU regulations will also significantly affect the performance of the economies. The EU Commission expects that the EU environmental legislation alone will cost between 2 and 3 percent of the CEEC's annual GDP during the transition period of five to seven years.[5]

The economic benefits of the common market may be able to mitigate many of the negative consequences of accession in the long term, but the economic growth that the CEECs enjoy will be suboptimal. That is a worry explicitly expressed by economists from the Institute of M. R. Stefanik, a Slovak think tank. According to them, EU accession will prevent further liberalization of the Slovak economy and require Slovak firms to provide too high a level of worker benefits.[6]

Mirek Topolanek, head of the Civic Democratic Party (ODS), the second largest political party in the Czech Republic, expressed his misgivings about the EU's regulatory drive. According Topolanek, in order for the Czech economy to grow, the Czechs must have the necessary economic flexibility. "By adopting an array of incomprehensible [EU] laws and regulations . . . we have permanently foreclosed that option."[7]

British commentator John O'Sullivan describes the disappointing nature of the accession in the following way: "Under the EU accession package, the 10 new members are supposed to receive the headline figure of $41 billion in adjustment subsidies. But when various dues and unforeseen items have been deducted, the actual amount they will get is a mere $10.6 billion over the next four years [2003–06]. Their poor but rising economies will have to absorb job-killing regulations designed for much richer societies. And to add insult to injury, their citizens will not be allowed to migrate to existing EU members until seven years after enlargement in May 2004. All in all, the net economic benefits to the new members may be small to non-existent."[8]

O'Sullivan's commentary sums up the disillusionment with EU accession that has spread throughout CEE. For more than a decade, the governing elites in CEE have been selling EU accession as unambiguously beneficial. But as the terms of the accession that the CEECs negotiated have become public, the citizens of CEE have recoiled at the prospect of having their tax burdens increased, their societies micromanaged, and their economic freedom restrained by ludicrously detailed and complicated EU regulations.

Furthermore, workers from CEE will initially be prevented from seeking jobs in the EU. The extent of that ban varies, but the two countries that historically absorbed most CEE workers, Austria and Germany, will be "protected" from CEE labor immigration for up to seven years.[9] The ban will compromise one of the EU's most fundamental principles—freedom of movement of labor—and thus condemn the CEECs to a second-class membership status for the foreseeable future. On a practical level too, the CEECs will be prevented from softening the economic impact of EU accession by the export of a competitive labor force.

Moreover, the size of the intergovernmental financial transfers from west to east, which were meant to offset some of the negative aspects of accession, has not met the CEEC's expectations. That is not to suggest that there should be more aid. Indeed, there is ample evidence that aid does more harm than good.[10] Rather, the point here is that the citizens of CEE were misled about the terms of accession. Thus, public opinion in CEE grew more critical of the EU as the date of the accession neared. For example, the EU Commission's own poll in 2002 found that only 32 percent of Estonians, 35 percent of Latvians, 43 percent of Slovenes and Czechs, and 48 percent of Lithuanians thought that joining the EU was "a good thing."[11]

Despite that, few observers believe that any of the national referenda, which will be held throughout the CEE prior to accession, will result in rejection of enlargement. Even the opponents of the European superstate, such as Czech president Václav Klaus, consider the enlargement a fait accompli.[12] The main reason for that type of fatalism is the fact that, although being a part of the EU may result in suboptimal growth, remaining outside the EU could be much worse.

Over the past 50 years, the EU has grown into a huge trading bloc that has the power asymmetrically to define the terms of trade relations with non-EU countries. The EU now has the power to sanction small countries that refuse EU dicta or try to hold out for more EU concessions. No example demonstrates this better than the EU's recent economic blackmail of Norway.

Norway, which is not part of the EU but does have a free-trade agreement with it, used differentiated tax rates for employers in order to benefit companies based in its northern, sparsely populated region.[13] The EU was concerned that those lower tax rates attracted investment away from the EU. Faced with possible financial penalties and economic sanctions, the Norwegian government backed down. Instead of fighting the EU, Norway accepted the possible loss of 30,000 jobs in the north.[14]

The European business community is increasingly disaffected as well. In a recent survey commissioned by the EU Commission, 65 percent of European businesses and organiza-

The EU has grown into a huge trading bloc that has the power asymmetrically to define the terms of trade relations with non-EU countries.

tions complained about the opaqueness of EU law.[15] As a result, the president of the EU Commission, Romano Prodi, promised to slash the volume of regulations by 25 percent. Similarly, at their meeting in Lisbon, the EU governments adopted a reform program in order to turn the EU into "the most dynamic and competitive knowledge-based economy in the world by 2010."[16]

But according to a British think tank, the Centre for European Reform, little progress has been made.[17] That is due to conflicting objectives in Brussels and in the member states. Whereas the EU members have an incentive to improve their economic performance through deregulation, the bureaucracy in Brussels sees regulation as a means of furthering its political goal of European unity. The EU integration process, therefore, struggles to come to terms with a potentially fatal contradiction: the long-term economic well-being of the European peoples is incompatible with centralization of political and economic decisionmaking in the hands of the unelected bureaucracy in Brussels.

The long-term economic well-being of the European peoples is incompatible with centralization of political and economic decisionmaking in the hands of the unelected bureaucracy in Brussels.

The effect of excessive EU regulations on long-term economic growth in CEE is a problem that has been ignored for too long. As Klaus has noted, "Everyone keeps talking about the benefits of enlargement and nobody talks about its costs . . . a serious debate is beginning as to the benefits of further integration and unification."[18] Indeed, if the impoverished CEECs are to achieve the EU standard of living, they will need to grow at a faster rate than the EU and narrow the wealth gap between them. According to the EU Commission, the CEECs got off to a good start and grew at an average annual rate of 3.4 percent between 1994 and 1999. During the same period, the EU grew by only 2.2 percent per year.[19]

This paper will argue that the CEECs should adopt a two-pronged approach to the problem of excessive regulation. First, as members of the EU, the CEECs will need to find ways of avoiding further limitation of tax competition by the EU, so that they can continue to offer better conditions to investors. Second, the CEECs will have to focus on repealing existing regulations—especially in the areas of agriculture, labor flexibility, and the environment—that are wholly inappropriate to the CEEC's current level of economic development.

Economic Liberalization in the Former Communist Bloc

Following the collapse of communism, most nations of the former Soviet bloc undertook some form of economic liberalization. However, market reform in Russia, Ukraine, Moldova, Kazakhstan, Belarus, Azerbaijan, Uzbekistan, Tajikistan, and Turkmenistan was limited or nonexistent for most or all of the postcommunist period.[20]

Governments of other former Soviet bloc countries undertook more reform. Anders Aslund of the Carnegie Endowment for International Peace divides the reformers into two categories, radical and gradualist. The radicals included the Czech Republic, Estonia, and Latvia under the leadership of Prime Ministers Klaus, Maart Laar, and Einars Repse, respectively; Poland under the guidance of Economics Minister Leszek Balzerowicz, and Hungary under the supervision of Harvard economist Janos Kornai.

A central element of radical reform was sound monetary policy and the elimination of hyperinflation. Most central banks in this group of countries became independent of governmental interference. Under communism most countries of the former Soviet bloc maintained various and mutually non-interchangeable exchange rates (e.g., import rubles, export rubles, petro-rubles). After the fall of communism, those exchange rates were unified. The CEE currencies were then either pegged or freely floated.

The CEE governments also tightened fiscal policy and eliminated large budget deficits. Prices were deregulated and many subsidies abandoned. Accompanying those measures were liberalization of domestic and foreign trade and privatization of many state-owned monopolies. Many restrictions on the activities of the private sector were done away with.

Whereas the radical reformers were convinced of the superiority of the free market, the gradualists retained some faith in the socialist economy and in the role of the government in stimulating economic growth. They chose to focus on the assumed shortcomings of the free-market system, and thus they argued for limiting the range of changes. The gradualists believed that radical reforms would lead to greater social costs and sharper declines in output than would be necessary under a more gradual approach.[21]

Not surprisingly, the greatest bastion of the gradualists was the former USSR, where socialism was most deeply embedded. The 1991 liberal reforms of Russian economics minister and later acting prime minister Yegor Gaidar, for example, were attacked from across the spectrum of Russian special interests, including Soviet academics, managers of the state enterprises, and trade unions. As Aslund notes, the managers of the state enterprises spearheaded the gradualist movement. Their economic vision was one of economic freedom for themselves and severe regulation for others. Free of state interference in decisionmaking, but relying on state subsidies and constrains on possible competition, they hoped to maximize their profits.[22]

Thus, instead of supporting sound monetary policy, the gradualists continued to argue for more investment in the moribund Soviet industries. Monies were printed and fiscal deficits mushroomed. The inevitable consequence was hyperinflation. The gradualists often opposed price deregulation, liberalization of exports of commodities, and large-scale privatization. Instead, they demanded more subsidies for agriculture, the energy sector, and big industrial enterprises.

How much have the countries of the former Soviet bloc liberalized? According to the 2003 *Economic Freedom of the World* report, published by the Fraser and Cato Institutes, of all of the former communist states, Estonia had the freest economy and ranked 16th in the world. Hungary, the Czech Republic, and Latvia followed, ranking 35th, 39th, and 51st, respectively. At the bottom of the list were Bulgaria (103rd), Russia (112th), Romania (116th), and Ukraine (117th). Belarus, for which there is a paucity of independent data, did not make the ranking.[23]

The 1997 Structural Reform Index of the European Bank for Reconstruction and Development also found the process of economic liberalization in the former Soviet bloc uneven. The index is measured on a scale between 0 and 1, with 1 representing a perfect score and 0 indicating no reform at all. In that index, the four Central European countries received an aggregate score of 0.88, and the three Baltic countries received a score of 0.77. Bulgaria and Romania received 0.67. Of the countries of the former USSR, Armenia, Georgia, and Kyrgyzstan received 0.66, and Russia, Ukraine, Moldova, and Kazakhstan received 0.65. Belarus, Azerbaijan, and Uzbekistan received 0.47 and Tajikistan and Turkmenistan 0.38.[24]

What was the result of the different approaches to transformation? All postcommunist states experienced an initial downturn in output. Those downturns ranged from 13 percent between 1989 and 1992 in the Czech Republic to 77 percent between 1989 and 1994 in Georgia. The aggregate decline of GDP in Central Europe was 19 percent, in the Baltics 44 percent, and in the Commonwealth of Independent States 53 percent.[25]

According to Balzerowicz, by 2000 the average real GDP in the CEECs had increased to 107 percent of that in 1989. In contrast, the comparable figure for the CIS was only 61 percent.[26] By 1998 Poland, Hungary, and the countries of the former Czechoslovakia had either reached or surpassed their 1989 GDP per capita in purchasing power. The Baltic countries, which experienced a sharper decline in GDP, were catching up with their 1989 GDP per capita in purchasing power faster than were their CIS counterparts.[27]

The markets reacted positively to countries with more extensive liberalization. Thus,

Countries that have reformed the most have also experienced a longer period of sustained economic growth.

The EU insists on standards wholly inappropriate to the current stage of CEE economic development.

the freer economies attracted the lion's share of foreign direct investment (FDI). In the Czech Republic, cumulative FDI per capita for the period between 1989 and 2000 came to $2,102. In Hungary that figure was $1,964 and in Estonia $1,400. Russia, on the other hand, received only $69 and Ukraine $68.[28]

Countries that have reformed the most have also experienced a longer period of sustained economic growth. Aslund compared the growth rates in the former Soviet bloc and found that between 1995 and 1997, the CEECs grew on average by about 5 percent per year. The economies of the CIS, on the other hand, experienced an annual contraction of 4 percent during the same period.[29] By 1999 only seven countries of the former Soviet bloc had experienced economic growth over 4 percent for three or more years. Most of those countries, Poland, Hungary, Slovakia, Estonia, and Lithuania, undertook significant reforms. The Republic of Armenia did well mostly because of a high initial contraction occasioned by war and embargo, and Azerbaijan's growth reflected the huge increase in oil production and oil-related investment.[30]

A look at the entire decade between 1990 and 2000 yields a somewhat different picture. The growth rates for the entire Soviet bloc are not as impressive, because they take into account the economic contractions that followed the collapse of communism between 1989 and 1991. Still, according to the World Bank, the four Central European countries (Poland, Hungary, Czech Republic, Slovakia) lead with a growth of 2.3 percent. Over the entire 10-year period, the Baltic countries experienced an average contraction of 2.3 percent. Not surprisingly, the countries of the CIS, which undertook the fewest reforms, suffered from the highest contraction of 5.9 percent on average.[31]

Of course, the length of communist rule, distance from the west, and past economic achievement affected economic performance as well. Still, some recent developments in the former Communist bloc further strengthen the link between economic freedom and economic performance. Following its financial crash of 1998, Russia adopted a flat tax of 13 percent and reduced its corporate tax rates. Those reforms, combined with the high price of oil, contributed to the 40 percent increase in tax revenue in 2001 and again in 2002. The country's economy experienced an average growth of 6 percent between 2000 and 2002. In 2003 Russia is expected to grow by 4 percent. Meanwhile, the CEECs grew by 2.3 percent in 2002 and are expected to grow at 3.7 percent in 2003.[32]

According to Aslund: "The more radical and comprehensive the initial reform has been, the greater economic success. Multicountry regression analyses invariably show that all major reforms have had positive impact. . . . Today, the empirical evidence of the benefits of a radical and comprehensive reform is overwhelming."[33] Indeed, but the CEECs still have much work to do. Despite a decade of liberalization, overall economic freedom in CEE lags behind that of prosperous industrial nations. It is for that reason that the constraining nature of the EU regulations is so troubling.

Regulation and Its Costs

In 1957 the Treaty of Rome promised to abolish obstacles to free trade across the European continent. As a result, European consumers today enjoy the benefits of free movement of goods across national frontiers. But the regulated nature of production, delivery, and sale that characterizes the European common market falls far short of the orthodox understanding of free trade.

The logic of the regulatory sentiment in Brussels was expressed well by Richard Corbett, a British member of the European Parliament for the Labour Party. As Corbett stated: "In the European Union, we now have an integrated market. Such a common market needs common rules in a number of areas: not just technical standards but consumer protection, environmental standards, competition policy, and fairness in the workplace."[34]

To be sure, the common market is an improvement on the era of nationalism and protectionism that preceded it. But there is no logical connection between the common market and common rules regarding such matters as technical standards, consumer protection, environmental standards, competition policy, and fairness in the workplace. The only thing necessary for the existence of an integrated market is borders open to the flow of goods and capital. How those goods are produced may be of interest to consumers, but a common market in no way requires a unitary state.

The set of regulations concerning internal trade in Europe and other social and economic aspects of European life is called the *acquis communautaire*. Under the terms of the enlargement, the CEECs are required to adopt the entire *acquis* prior to the accession. But some countries have negotiated "transition periods" during which they will be allowed to gradually implement all the relevant regulations.

The *acquis* is divided into 31 chapters and includes regulations governing free movement of goods, freedom of movement for persons, and free movement of capital. It provides for common competition, transport, agricultural, and fisheries policies. There are chapters dealing with the monetary union, energy, industrial policy, science and research, education and training, culture and audiovisual policy, consumer protection, justice, customs, and so on. There is even an embryonic common taxation policy. Below I will discuss costs associated with three chapters in particular—those on common employment and social policy, environment, and agriculture.

Those chapters are of particular importance to the new EU members. Overregulation of conditions of employment will diminish the comparative advantage that CEE workers enjoy over their more highly paid western counterparts. Western standards of food production will push many CEE producers out of business. That negative effect of accession will be further exacerbated by the unfair nature of EU agricultural subsidies. With regard to the environment, the EU insists on standards wholly inappropriate to the current stage of CEE economic development. Together, those three chapters pose the most significant costs to the CEECs.

Common Employment and Social Policy

Today, the EU specifies the terms of contract between employer and employee through regulations varying from the European agreement on parental leave to the EU directive on the minimum level of training of seafarers.[35] Regulations micromanaging working times cover, for example, the road transport industry and civil aviation.[36] There is a European directive on the general organization of working time, which mandates that employers limit the workweek to an average of 48 hours.[37] That directive also imposes a limit of an average of 8 hours of work a day, which nightworkers can be required to work, and gives them a right to receive free health assessments. It gives employees a right to 11 hours rest a day. It mandates a right to a day off each week and a right to an in-work rest break if the working day is longer than 6 hours. It further mandates a right to four weeks paid leave per year.[38]

Other agreements regulate health and safety requirements, often in complex detail. One directive, for example, sets minimum health and safety requirements for employees working with vibrating machinery in order to prevent "neurological and vascular disorders."[39] The directive, therefore, limits hand-arm vibration to the daily limit of 5 m/s2 and whole-body vibration to 1,15 m/s2. It then offers a guide to calculating the acceptable levels of vibrations "as the square root of the sum of the squares (rms) (total value) of the frequency-weighted acceleration values, determined on the orthogonal axes ahwx, ahwy, ahwz as defined in Chapters 4 and 5 and Annex A to ISO standard 5349-1(2001)." Though the idea of an employer overseeing his employees with a calculator in one hand and a stopwatch in the other hand may seem preposterous, the directive insists that "the employer shall assess and, if necessary, measure the levels of mechanical vibration to

Regulations against the pejoratively labeled concept of "social dumping" contribute not to alleviation but to worsening of the workers' lot.

The EU members with the most rigid labor markets are determining the EU's social agenda.

which workers are exposed. Measurement shall be carried out in accordance with Point 2 of Part A or Point 2 of Part B of the Annex to this Directive, as appropriate."[40]

The European Commission started to regulate employment laws, health and safety in the workplace, and equal opportunities in the early 1970s. In 1989 the Social Charter was adopted. The principles of the charter were then incorporated into the Maastricht Treaty in 1992. The aim of those measures is "the development and full implementation of minimum social standards for the single market."[41] Thus, many aspects of labor law are being "harmonized" at a European level. The EU has issued directives in the fields of "collective redundancies (i.e., layoffs), safeguarding of employment rights in case of transfer of undertaking, employer obligation to inform employees of the condition applicable to the employment contract, guarantee for the employees in case of insolvency of the employer, posting of workers and organization of working time," and minimum health and safety standards in the workplace.[42]

The EU mandates that the CEECs phase in a body of such directives, with each phase becoming progressively more restrictive as to the freedom of contract between employer and employee and more costly with regard to enforcement. Although the EU claims to wish to "avoid imposing administrative, financial and legal constraints which would hold back the creation and development of small and medium sized undertakings," its policies are likely to have that effect.[43]

The EU explicitly rejects the possibility of different levels of safety and health protection of labor within the union. Instead, it asserts the need to harmonize health and safety standards irrespective of the different needs of the member states. Thus, the EU's founding health and safety legislation directive rejects the idea of taking the costs of health and safety regulations into account in business decisionmaking.[44]

According to the EU, legislation is necessary "not only to ensure the health and safety of each worker on an individual basis, but also to create a minimum basis of protection for all Community workers in order to avoid possible distortions of competition."[45] The EU does not offer criteria for determining what a competitive distortion is or how it plans to legislate without creating market distortions.

However, as other EU statements demonstrate, the EU's understanding of "competitive distortion" has less to do with possible market failure than with old-fashioned protectionism. As the official website of the EU Commission explains: "The EU has established a set of conditions for membership that new member states must fulfill. They include the requirement that each new member must implement and enforce EU law, which includes key areas of social policy such as limits on working time, minimum standards of safety in the workplace, gender equality and other measures to combat discrimination. Thus the risk of 'social dumping' will be avoided."[46]

From an economic point of view, it would seem that the CEE economies ought to derive maximum benefits from lower costs of production, not least because their productivity lags behind that of their western counterparts—something that the EU actually recognizes. To stay competitive, in other words, the CEECs need to keep the costs of production down. The alternative to increasing productivity is growing unemployment. And the latter is precisely what the EU laws will lead to. In countries such as Poland and Slovakia, where 20 percent of the working population is unemployed, regulations against the pejoratively labeled concept of "social dumping" contribute not to alleviation but to worsening of the workers' lot.

Here the East German example is most instructive, for it shows how an artificial increase in labor costs proved counterproductive to East German economic development and led to the perpetuation of high unemployment. In 2000, a decade after German unification and 2 trillion deutsche marks of financial transfers later, unemployment in the eastern part of the Federal Republic was more than twice as high as it was in the west.[47] That is exactly what Kadi Parnits, president of a joint body of Estonian trade unions (EAKL) fears. According to Parnits, the EU labor legislation "costs," which is why she expects "some factories . . . to close down." Moreover, she complains that "other safety improvements will harm our possibilities of raising wages."[48]

I do not mean to dismiss concerns regarding workers' safety and health but to point out how EU legislation impairs the productivity of employers and employees alike. As the Centre for Research into Post-Communist Economies argues, "Far from aiding competitiveness . . . [the EU social legislation acts] to discourage competition on costs, raise the barrier to entry in many sectors, discourage firms from taking on labor (and labor training) and promote the collective passing-on of the resulting higher costs in higher pricing—putting all EU manufacturers at an equal disadvantage against foreign producers."[49]

High unemployment in the EU is commonly attributed to excessive social legislation on the national as well as the supranational level, which makes it costly to hire and fire new workers.[50] Unfortunately, the EU members with the most rigid labor markets are determining the EU's social agenda. What sense does it make to force the CEECs to adopt the same kind of failed social policies? It is apparent that EU members that are incapable of reforming their welfare states in the face of opposition from deeply entrenched special interests are set on preventing the countries in CEE from implementing policies that would result in "too much" competition.

The EU has not evaluated the financial costs to the economies of CEE of the common employment and social policy. But the growth of the bureaucracy responsible for enforcement of the EU regulations can be used as an indicator of rising costs. By the time of the CEEC's accession, the EU plans to hire an additional 5,161 bureaucrats to oversee the new members' compliance with the *acquis communautaire*.[51] Of course, officialdom will expand in the individual nation-states as well.

In fact, the EU Commission has repeatedly evaluated the progress different countries have made on the way to becoming new members of the EU by the numbers of new bureaucrats those countries have employed. For example, the EU Commission commended the Hungarians for "boosting" their National Labour Inspectorate by 80 new officials during 2002.[52] The Czechs were compelled to expand their Ministry of Labour and Social Affairs by an additional 450 staffers assigned to the new Occupational Safety Office.[53] But bureaucratization of economic life is precisely what the CEECs tried to get away from by jettisoning communism in 1989. It is ironic that more, not fewer, bureaucrats should characterize the CEEC's entry into the EU.

Environmental Regulations

EU environmental legislation covers environmental quality protection, production processes, and products. It sets air quality standards; waste management procedures; water and nature protection measures; industrial pollution controls; regulations concerning chemicals and genetically modified organisms; and regulations regarding noise, nuclear safety, and radiation protection.[54]

Specific regulations range from sensible ones concerned with transboundary transport of nuclear waste to others that are far less sensible.[55] Those include decisions on ecological criteria for the award of the EU eco-label to bed mattresses, dishwashers, and light bulbs.[56] As benign as those regulations may seem, they should not be dismissed as insignificant.

Regulations increase bureaucratization of economic life and bring about "public choice" dilemmas, such as rent seeking. The 2001 decision that granted Portugal "a derogation regarding urban waste water treatment for the agglomeration of the Estoril coast" is instructive.[57] In Brussels-speak, "derogation" is an exception granted by the EU to a particular regulation. Depending on the political weight of the member states and the compromises they are willing to make in unrelated areas, the members can receive postponements of and exceptions from costly regulations. Such practices, however, place disproportionate costs on less politically powerful states and skew the decisionmaking process.

EU members are set on preventing the countries in CEE from implementing policies that would result in "too much" competition.

By insisting on Western environmental standards, the EU will likely contribute to the prolongation of economic malaise in CEE.

Still other regulations have a more immediate impact on the economy and can be met only through substantial expenditure. The EU environmental regulations include directives concerning the quality of drinking water, bathing water, and groundwater.[58] They set national emission ceilings for atmospheric pollutants such as sulphur dioxide, nitrogen dioxide, and other oxides of nitrogen and limit emissions from large combustion plants, compression-ignition engines, and positive-ignition engines.[59] The EU also requires compliance with costly directives on all types of waste.[60]

Compliance with EU environmental standards will have to be policed by scores of additional public officials. In 2002 the EU approvingly noted that the Czech Ministry of the Environment beefed up its staff, which then carried out about 19,500 inspections and imposed 2,627 fines worth approximately 2.1 million euros.[61] Overall, the EU Commission estimated the cost of CEE compliance with the new environmental regulations at between 80 billion and 120 billion euros.[62]

That expense will have to be met by the end of the transition period, which most CEECs negotiated in order to spread the costs of environmental adjustment. The conclusions of the transition periods vary, but most will come to an end by 2013. In other words, over the next 10 years, the CEECs will have to meet environmental expenditures of as much as 10 billion euros per year. The CEE governments will have to assume the increased financial burden and meet it out of general taxation or borrowing. Private enterprises will see their profits diminished by increased taxation; consumers will have to pick up the tab for lowering emissions; and municipalities will have to find the funds to improve standards for wastewater and solid waste.

By insisting on Western environmental standards, the EU will likely contribute to the prolongation of economic malaise in CEE. That is especially troubling since the EU approach to the environment goes against a growing body of research that links environmental improvements to economic growth. One OECD study, for example, found that economic development transforms the composition of industry, making it more sophisticated and cleaner.[63] Similarly, the World Economic Forum's *2001 Environmental Sustainability Index* found that environmental standards rise with increases in per capita GDP.[64]

"As [a] country sees its standard of living rise through economic liberalization and trade expansion," Cato scholar Daniel Griswold explains, "its industry can more readily afford to control emissions. Its citizens have more to spend, above what they need for subsistence, on the 'luxury good' of improved environmental quality. . . . That explains why the most stringent environmental laws in the world today are found in developed countries that are relatively open to trade."[65] To put it differently, the EU should have focused on rapid growth in CEE, which would be followed, not preceded, by improvements in environmental standards.

The EU is clearly aware of the impact that its legislation will have on the CEE economies. As the EU Commission states, when it comes to the environment, "there will be no lowering of standards—a basic principle that applies to all aspects of the enlargement process. This is important also for the unity of the Single Market, to ensure a level playing field for business."[66] Unfortunately, the EU will create that "level playing field" by making the CEECs less competitive.

Common Agricultural Policy

The Common Agricultural Policy is one of the most controversial parts of the European project. The CAP consumes 46 percent of the EU's total annual budget of 100 billion euros. As one European commentator, William Rees-Mogg, noted: "The annual dairy subsidies given by the CAP and the European governments put together come to more than $800 per cow. That is greater than the individual income of half the world's population including more than one country from the former Soviet Union."[67] Of course, agricultural subsidies are common throughout the world and amount to an annual $300 billion in OECD countries alone. Still, the EU spends almost twice as much to subsidize its farmers as does the United States.[68]

Though it was designed as a "food security" mechanism, the CAP has evolved into a system for supporting inflated agricultural prices, thereby securing the centrally determined income levels of farmers. Those measures resulted in price levels that were constantly above world market prices. That, in turn, led to overproduction and the notorious mountains or lakes of agricultural produce. At the same time, European consumers were prevented from purchasing food at lower prices. The 1992 CAP reform lowered the EU subsidies but introduced "a compensatory system of direct [farm] support . . . often connected with an undertaking to lay land fallow."[69]

Since the CAP encourages overproduction, it necessitates a system of production quotas. Thus, the accession negotiators fought over every sheep and liter of milk. For instance, Slovakia requested that it be allowed to produce 1.2 billion liters of milk, but the EU set the limit at 950 million liters per year. The union wanted Slovakia to raise only 218,000 sheep, but Slovakia wished to raise 400,000.[70] Slovak farmers can be excused for complaining that that type of economic decisionmaking is eerily reminiscent of production quotas under Soviet occupation.

The 10 candidate countries will receive 5.1 billion euros from the EU between 2004 and 2006. That "direct" subsidy will be phased in over a 10-year period. The CEECs will thus receive 25 percent of what the current members get in 2004, 30 percent in 2005, and 35 percent in 2006. According to the terms of the settlement, the new members will be allowed to top off EU subsidies from their national budgets by 55 percent in 2004, 60 percent in 2005, and 65 percent in 2006. (Until 2006 the national top offs can be cofinanced from the EU rural development funds. After 2007, however, the new member states will be allowed to use only their national budgets to top off EU payments by up to 30 percent above the applicable phasing-in levels of EU subsidies.)[71]

To be sure, subsidizing agricultural production out of their national budgets will continue policies that the CEECs already had in place. The CEE subsidies do, however, need to be seen in the context of unfair EU competition. Though the EU explicitly promised to remove quotas and tariffs on agricultural imports from CEE, that promise never materialized. The EU did, however, continue to dump its subsidized agricultural produce on the CEE market, thus effectively increasing the pain of the transformation process.[72]

As Detlev Samland, chairman of the Committee on Budgets of the EU Parliament, testified before the British House of Lords Select Committee in 1997: "If you look at the balance today between the Eastern European countries and the [European] Union, even in the agricultural sector we are exporting more to the East European countries than they to us. . . . Germany is exporting more agricultural products to Poland than Poland to Germany. The reason behind this [is] not that [Poland is] more expensive and we are cheaper; we are only cheaper because of the system. We reduce the prices of products by 50 pfennings for each German mark. So 50 percent is subsidy from the taxpayer. The Polish agricultural sector is not able to compete . . . [because] they get [only a] 15 percent subsidy [from their own government] instead of 50 percent."[73]

Using flawed economic logic, the EU Commission has even boasted about the agricultural trade surpluses that the EU enjoys vis-à-vis the applicant countries.[74] In fact, those venerated surpluses are not an outcome of higher productivity of EU farmers but a result of the EU's ability to "outsubsidize" its eastern competitors.

According to the Hungarian opposition party, Fidesz, which has been critical of the terms of the EU enlargement, Hungarian agriculture may lose up to 1,300 billion forints ($6 billion) over the next 10 years. The EU accession, Fidesz worries, may reduce Hungary's production capacity and endanger the export orientation of Hungarian agriculture. "As a consequence of the decrease of consumption and living standards we [Hungarians] might become net importers of such products that we used to export before."[75]

The EU agricultural policy goes beyond the CAP. The EU micromanages an array of economic activities, including marketing of veg-

Farmers can be excused for complaining that EU economic decisionmaking is eerily reminiscent of production quotas under Soviet occupation.

Slow growth in the EU raises questions about the appropriateness of the European economic model for future prosperity in CEE.

etable seed, seed potatoes, peas, and poultry.[76] One EU regulation even aims to increase the production of thyme honey on small Aegean islands by subsidizing beekeepers who have at least 10 fixed hives registered with the competent authority.[77]

Stringent EU agricultural and food safety policies will also make the CEECs less competitive.[78] To ensure compliance, the EU Commission has voted itself extraordinary powers to "protect" the internal market of the current members against CEE agricultural produce for three years after accession. Ostensibly, those powers are intended to guarantee the safety of CEE exports, but some observers justifiably fear that they may turn out to be protectionist measures.[79] Should the EU judge certain agricultural products "unsafe," they will be banned.

Although not aimed at CEE agricultural producers, the EU has used "safety concerns" to ban the imports of American genetically modified (GM) foods. GM foods have been consumed in the United States for more than a decade. No adverse effects have been observed. Yet despite the EU's inability to offer evidence of the harmfulness of GM foods, the EU continues to discriminate against U.S. imports on health and safety grounds. Moreover, the EU continues to pressure client sub-Saharan countries to refuse American food aid, despite the fact that millions of people throughout that region starve. As James Glassman of the American Enterprise Institute points out, the EU's attitude has less to do with worries about safety of GM foods than with the competition that more efficient U.S. farmers pose to their European counterparts.[80]

The European Economy: Warning Signs for the CEECs

With average per capita income ranging from $10,070 in Slovenia to $3,700 in Slovakia, the standard of living in most CEECs is still low.[81] But the CEECs have been narrowing the gap. In 2002 the Slovak economy grew by 4.4 percent, whereas the German economy grew at only 0.2 percent.[82] Such slow growth in the EU raises questions about the appropriateness of the European economic model for future prosperity in CEE.

Most EU economies are beset by deep structural problems, including rigid labor markets, restrictive regulations, expensive environmental and safety standards, high taxes, and large unfunded liabilities. As World Bank data show, between 1992 and 2001 the German economy grew on average by 1.45 percent per year and the French economy by 1.88 percent. The Irish economy, which is more akin to the American model, grew by 7.65 percent during that same period and the British economy by 2.58 percent. Between 1992 and 2001 the U.S. economy experienced an average growth of 3.46 percent per year.[83]

When it comes to employment, the EU also lags behind. Over the past decade, the rate of unemployment in Germany and France has been hovering around 10 percent, which is roughly double that of the United States. About 40 percent of the unemployed in Europe have been without jobs for more than a year. A comparable figure for the United States is only 6 percent. Since 1970 the U.S. economy has created 57 million new jobs. The EU, despite having a larger population, has not created a single net new job in the private sector since 1970. The only increase in employment that the EU experienced was in the government sector.[84]

Europe has also lagged in productivity. American workers, for example, generate 27 cents more output per dollar of input than European workers do. In France and Belgium, employees are, in addition to their vacations, entitled to at least 26 paid national holidays. The average German is paid for 14.5 months of work per year but works only 9.5 months.[85] Whereas before they were roughly equal, today European GDP per capita is less than two-thirds of that of the United States. The United States today produces 30 percent of the world's GDP. That is 8 percent more than it produced in the late 1980s.[86] Slow growth, generous social provisions, and high unemployment mean that more and more of European citizens' income is taxed in order to cover government liabilities.

Adding to those problems is the dramatic decline of birthrates across the EU. If trends continue, over the next 50 years Germany's population will decline from 87 million to 67 million and Italy's will decline from 58 million to 39 million. By the 2030s half of all Germans are expected to be over the age of 50 and half of Italians over the age of 54. Declining birthrates are important because of Europe's unfunded future liabilities, such as pensions. As a 1993 OECD study warned, the unfunded pension liabilities of Germany amount to 150 percent of GDP; in Italy and France they amount to more than 200 percent. By the 2030s every employee in the EU will support one retired person over the age of 65. Unless some reform is undertaken, Italy will have to increase its payroll taxes for pensions from 33 percent to 48 percent, an unrealistic percentage. The pension system in France is expected to be in deficit in eight years time, but special interests have prevented any reform from taking place.[87]

In fact, the CEECs have been more farsighted with regard to pension reform than have their western neighbors. Hungarians were the first to partly privatize their pension system in 1998. The Poles followed suit. In Slovakia, the government has announced a plan to partly privatize the pension system as well. In contrast, the German proposal for "reform" will increase taxes and raise the age of retirement from 60 to 67 years.[88] This will only contribute to the further fossilization of the labor market and deprive workers of the freedom to retire at the time of their own choosing. Without fundamental change, the best that EU countries can do is to push back the day of reckoning with increased taxation or reduction of benefits.

Despite their huge economies and their historically large tax revenues, it is clear that even the richest of the EU states cannot maintain their generous social provisions indefinitely. The pay-as-you-go pension system alone is capable of bankrupting EU members in the near future. The implications of the EU's economic problems for the impoverished CEECs are, therefore, clear. Instead of attempting to maintain the current level of spending, which they cannot afford, the CEECs should opt for high-growth economic policies.

The Brussels Bureaucracy

Some recent political reforms in the CEECs were driven by the prospect of joining the EU. The Slovaks, for example, jettisoned their former nationalist leader, Vladimir Meciar, in part because of EU criticism of his undemocratic policies and also because the EU made it clear that it would not deal with him. Similarly, the perception that Prime Minister Victor Orban's revisionist agenda was going to harm Hungary's accession to the EU contributed to his electoral defeat in 2002.

However, the fact that the EU wishes to conduct business with only democratically elected governments does not imply that the EU is committed to a number of attributes associated with democratic rule, such as evenhandedness, self-criticism, transparency, and accountability. The EU commissioners consistently agitate in favor of pro-European parties of the center left. When successful, those parties then further the cause of Brussels bureaucracy in the European Parliament and in the European Council. That "you-scratch-my-back-and-I'll-scratch-yours" policy has resulted in a succession of socialist EU commissioners and heads of the commission.

Electoral gains by the center-right parties, which often espouse more critical attitudes toward the EU bureaucracy, are derided as xenophobes. Valid criticism is often dismissed as an expression of ultranationalism or anti-Europeanism. But that kind of easy dismissal of differing opinions only contributes to the further distancing of the EU bureaucracy from local political realities. The EU's aloofness regarding the legitimate concerns of the European public on issues such as criminality and immigration is a con-

It is clear that even the richest of the EU states cannot maintain their generous social provisions indefinitely.

Harmonization is one of the most worrying elements of the EU integration process.

tributing factor to the radicalization of public opinion and the electoral success of more extremist parties, such as the British National Party and Austria's Freedom Party.

Also of concern is decisionmaking in the EU. The Council of Ministers is the EU's main decisionmaking body. In addition to serving as the EU's upper house of parliament, the council coordinates economic and foreign policy of the member states. Yet it meets in secret and issues no records of proceedings or votes of individual ministers. The governments of the member states appoint the president of the EU Commission. The EU Parliament can confirm or reject a specific candidate, but it cannot nominate one. The same goes for all of the EU commissioners. The EU Commission is a powerful institution, which has a monopoly on the initiation of European legislation and is responsible for the EU's budget and for implementing EU legislation, including all directives, regulations, and decisions. The commission also represents the EU in the international arena and negotiates international agreements on crucial issues such as trade. Yet once it is appointed, the EU Commission is not subjected to further democratic oversight.

As a result, the EU Commission is rife with corruption, which led to the resignation of the entire EU Commission under the presidency of Jacques Santer in 1999. Paul van Buitenen, the Dutchman whose investigation of the practices of the EU Commission brought Santer down, resigned his post in 2002 after admitting defeat in his attempts to root out corruption. He called the EU machinery "unreformable."[89] Buitenen's resignation comes in the wake of the firing of the commission's chief accountant, Marta Andreasen. She was removed from her post after she said that the accounting practices of the EU Commission were worse than those of the disgraced U.S. Company Enron. As she stated: "Unlike the issues surrounding Enron and WorldCom, where you can at least trace transactions and accounts, you cannot do so within the EU accounts as there is no system in place for tracing adjustments and changes to figures presented. . . . Fraud can, therefore, lie hidden within the system, undetected and untraced."[90]

Harmonization: A Shortsighted Solution

Harmonization is one of the most worrying elements of the EU integration process. Lack of political uniformity enabled Europe to thrive in the past. "Fragmentation," Harvard University historian David Landes writes, "gave rise to competition and competition favored good care of good subjects. Treat them badly and they might go elsewhere. . . . European rulers and enterprising lords who sought to grow revenues . . . had to attract participants by the grants of franchises, freedoms and privileges—in short, by making deals. They had to persuade them to come."[91]

The autonomous city-states, which dominated the European political landscape until the rise of the nation-states, offered to potential émigrés assortments of different freedoms, forms of association, and legal statuses. They also tried to gain an edge over their competitors by lowering their taxes. Tax competition kept the overall level of taxation in check. As a result, all nations benefited from increased innovation. Social experimentation was also important. The freedom of worship in the Low Countries, for example, enabled the persecuted Spanish Jews to seek refuge there. Many of those émigrés brought with them knowledge and expertise that contributed to the increased prosperity of the more tolerant societies.

In the economic sphere, the EU has chosen to deal with increasing economic competition by harmonizing regulations across the Continent. By submerging potential competitors in the superstructure of EU legislation, current EU members can avoid making themselves more competitive. As Klaus warned, "The claims for quasi-universal social rights are disguised . . . attempts to protect high-cost producers in highly regulated countries, with unsustainable welfare standards, against cheaper labor in more productive countries."[92]

No example better illustrates the above point than the EU's attempts to reduce what it calls "harmful tax competition." As the EU Parliament noted, it may be necessary to harmonize business taxes because "cutting taxes in one country raises the competitiveness and/or attractiveness of this country relative to others. The resulting flows of goods, capital—and also, possibly, high-skilled labor—is detrimental to partner countries in terms of economic activity and in terms of tax revenues."[93]

Harmonization of taxes, however, is likely to stunt economic growth in low-tax countries. As recent trends show, countries with lower taxes grow faster than countries with higher taxes. Ireland, for example, reduced its top marginal tax rate from 80 percent in 1975 to 44 percent in 2001. Similarly, the Irish government cut the standard tax rate from 35 percent in 1989 to 22 percent in 2001, and the general corporate tax rate was cut from 40 percent in 1996 to 24 percent in 2000. Ireland also introduced a special 10 percent corporate tax rate for manufacturing companies and companies involved in international trade in services. Ireland's total tax revenue in 1999 was 31 percent of GDP. The comparable figure in the rest of the EU averaged 46 percent.[94] As a result, the Irish economy grew at an average annual rate of 7.65 percent between 1992 and 2001. During the same period, the German and French economies grew at an average annual rate of 1.45 percent and 1.88 percent, respectively.

Harmonization will make it easier for the European welfare states to postpone dealing with their economic problems. The postponement will both make those problems larger and push some costs onto EU accession countries.

Estonia provides one example of the negative effects of harmonization on accession countries. After the collapse of socialism, Estonia rapidly liberalized its economy. Now, unfortunately, it will have to move in the opposite direction. As Razeen Sally of the London School of Economics comments, the downside of Estonian membership in the EU is most apparent in trade policy. "Estonia will have to erect a vast wall of common external tariffs against non-EU countries, starting this year [2000], jumping from last year's baseline of zero to a total of 10,794 different tariffs. This will result in serious distortions, and will particularly increase the cost of food. . . . [Also] upon accession Estonia will have to introduce a panoply of EU non-tariff barriers [e.g., subsidies, quotas, and antidumping duties] that will divert imports from low-cost locations outside the EU to high-cost locations within it. In particular, imports of coal and steel will become more expensive."[95]

Forcing a nation to opt for a particular set of social arrangements may be in line with the EU accession requirements, but it may not be in line with determining the best set of social arrangements. Harmonization will deprive Europe of the possibility of a large amount of policy competition—the very aspect of European life that made Europe prosper in the past.

Harmonization of taxes is likely to stunt economic growth in low-tax countries.

Future Strategy

Even though the popularity of the EU in CEE has dramatically declined over the past two years, EU enlargement will go ahead. So, what should the CEECs do after accession? One option is for the CEECs to try to join the rent-seeking battle among the member states for ever-increasing pieces of a shrinking EU pie. Already, the Hungarians are preparing to cast aside the stigma of "second-rate" EU membership and make a case for increased and sustained agricultural subsidies. Hungary's second largest political party, Fidesz, recently declared, "We, Hungarians have to bear in mind that in the economy and social life of our country's agriculture has a more significant role than in most of our future fellow member states, therefore in the Union, as well, we have to support the maintenance and development of the agricultural system based on the subsidies for the family estates."[96]

The CEECs will have a stake in seeing the EU transcend its current problems and reform in a way that will lead to long-term economic growth.

But economic reality in the EU makes such a policy unsustainable. Other, more powerful members of the EU are not only determined to keep transfers to CEE to a minimum; they are also set on minimizing the influence of small countries in EU decisionmaking. The recent Franco-German proposal to eliminate the rotating presidency in favor of a commission president elected by the parliament and a long-term council president elected by the member states is a case in point.[97] Whereas under the rotating presidency, all states, no matter how small, presided over the EU automatically, the new system will favor large states that can muster enough votes in the EU Council and Parliament.

In order to be admitted, the CEECs had to accept many conditions they were not happy with. As members of the EU, however, the CEECs will have a stake in seeing the EU transcend its current problems and reform in a way that will lead to long-term economic growth. What avenues are available to the CEECs to achieve such reform?

- **Forge Alliances with Liberalizing Governments:** Harmonization of welfare entitlements and direct taxation is a thereat to the CEECs. Luckily, some of the current EU members are also worried about the socialist tendencies of Brussels. Italy and Spain under Prime Ministers Silvio Berlusconi and José María Aznar have shown themselves to be interested in meaningful reform. Both states are European heavyweights and will prove pivotal to counterbalancing the Franco-German alliance. But the leader of the liberalizing bloc will have to be Great Britain. Liberalization may have been difficult for Tony Blair's Labour Party to accept, but Great Britain's relatively free market continues to provide it with economic growth that continuously outpaces that of the Continent. Also, historically, the British have been much more sensitive to the question of taxation and repeatedly rebelled when taxes became too burdensome. It is unlikely, therefore, that the British government will accede to taxes determined or collected, or both, by Brussels.
- **Prevent Adoption of a Constitution Based on Welfare Entitlements:** An important opportunity for the CEECs will present itself during the 2003–04 constitutional debate. The predominant sentiment in Brussels, Paris, and Berlin seems to be set on enshrining in the EU constitution many of the pillars of the welfare state. The constitution, it is often stated, is to ensure the continuation of "social" Europe. The CEECs should not blindly follow the lead of their western counterparts. The EU constitution will be a legally binding and enforceable document, and all entitlements in it will have to be paid for. Thus, as they begin participating in all formal EU Council meetings, committees, and working groups, the CEECs should focus on minimizing constitutional provisions that enshrine costly entitlements.[98]
- **Guard the Veto System and Try to Extend It:** Historically, decisions of the EU had to be taken by consensus. Because of a national veto, decisions taken had to benefit all countries. Although it made EU decisionmaking slow and cumbersome, the veto prevented much disgruntlement. Regrettably, by the time the CEECs join the EU, the only meaningful veto in the area of economics and development will concern taxation. But the threat to the "tax" veto should not be underestimated. In preparation for the enlargement, for example, the EU Commission disapprovingly noted, "The absence of EU rules on salary levels, welfare contributions and most aspects of direct taxation means that the new members will be able to 'compete.'"[99] The "tax" veto should thus be explicitly protected by the new constitution. In the future, the CEECs should also attempt to regain some of the lost

aspects of national sovereignty, including control over employment, environment, and agriculture policies.

- **End or Substantially Limit the Common Agricultural Policy:** Another area where change will have to take place sooner or later is agriculture. An interesting opportunity will emerge in 2006 when the union's budget for the next seven years will be discussed. At that point, the CEECs should push to abolish the CAP. Failing that, the CEECs should attempt to substantively reform it. By 2006 the direct EU subsidies for CEE agricultural goods will have reached only 35 percent of those for the west. Parity in subsidies, therefore, will still be a long way off. The CEECs will have an incentive to bring the future allocation of CAP funds to the fore. Because of the sluggish growth of the major EU economies, the EU budget is not likely to grow much. The CEECs can succeed in winning more money for their farmers only if other EU spending is cut. But that scenario is unlikely. If, on the other hand, the CEECs ask for parity with their rich counterparts, they will be more likely to succeed. The easiest way to achieve parity will be to decrease spending on the west European farmers.

As long as the CEECs retain some autonomy and use it to adopt market-friendly reforms, they can help to move European economic reform forward by demonstrating that markets generate desirable outcomes. They can show the benefits of low taxation and attest that market solutions are in the long run more sustainable than public-sector monopolies. Pension reform is a good example. According to Jan Oravec of the F. A. Hayek Foundation in Slovakia, an organization that has been instrumental to the program of extensive economic reform in that country, there is a possibility that "accession countries will be able to bring a new dynamic to Europe."[100] It is to be hoped that the CEECs will be able to supply such policy competition before they themselves begin to suffer the consequences of an overbearing bureaucracy in Brussels.

Notes

1. Helen Szamuely and Bill Jamieson, *A "Coming Home" or Poisoned Chalice?* (London: St Edmundsbury, 1998), p. 26.

2. David Heathcoat-Amory, "The Proposed EU Constitution Fundamentally Changes the Union," *Daily Telegraph*, June 18, 2003, www.telegraph.co.uk/opinion/main.jhtml?xml=/opinion/2003/06/18/do1801.xml.

3. Most of the EU regulations referred to in this paper can be found on the official website of the EU, www.europa.eu.int/eur-lex/en/index.html. The specific regulation referred to in this paragraph can be found at http://europa.eu.int/eur-lex/en/consleg/pdf/1994/en_1994R2257_do_001.pdf.

4. Razeen Sally, "Free Trade in Practice, Estonia in the 1990's," *Central Europe Review*, July 10, 2000, www.ce-review.org/00/27/sally27.html.

5. "Billions of Euro Needed for Candidates to Implement EU Laws," *EUobserver*, January 22, 2003, www.euobserver.com/index.phtml?sid=15&aid=9110. See also the official website of the EU Commission, http://europa.eu.int/comm/environment/docum/01304_en.htm.

6. "Economic Consequences of Slovakia's Accession to the European Union," Conservative Institute of M. R. Stefanika, Bratislava, Slovakia, December 2002, p. 59.

7. "Mirek Topolanek, Novy Predseda ODS," *Lidove Noviny*, December 16, 2002, www.lidovky.cz/osobnost.asp?t=FCXHCY.

8. John O'Sullivan, "Burdensome Regulation Will Strain New EU States," *Chicago Sun-Times*, December 17, 2002.

9. "Enlargement Dispute Solved," *EUobserver*, June 1, 2001, www.euobserver.com/index.phtml? aid=2479.

10. When the EU "aid" started to be disbursed through the structural and cohesion funds, 44 percent of the EU population lived in the regions that qualified for it. By 1997, however, that percentage had increased to almost 52 percent. Clearly, the program failed in its main task of lowering the number of people living in the areas eligible for aid. It also failed to stimulate economic growth. What it did stimulate was creation of special interests unwilling to see the amount of money they receive lowered. Spain, for

example, receives 23 percent of all funds. Not surprisingly, the Spanish put up a mighty fight to keep their share of the transfers and even threatened to veto the EU enlargement as a whole. In addition, the funds stifle economic reform throughout the EU. As Szamuely and Jamieson, scholars from the Centre for Research into Post-Communist Economies, observe, "Cohesion Fund disbursements can discourage government from measures that would otherwise encourage a switch from consumption to investment, while soft loans to redundant steelworkers could slow necessary re-adjustments and re-training." Szamuely and Jamieson, pp. 51, 75. See also "Enlargement Dispute Solved."

11. EU Commission, "Candidate Countries Eurobarometer 2002: First Results," http:// europa .eu.int/comm/public_opinion/archives/cceb/2002/cceb_2002_highlights_en.pdf.

12. "Czech Republic: New President Expected to Speak Loudly on Foreign Policy," Radio Free Europe, March 7, 2003, www.rferl.org/nca/features/2003/03/07032003174045.asp.

13. "EEA Rules Could Cost Up to 30,000 Norwegian Jobs," *EUobserver*, February 21, 2003, www.euobserver.com/index.phtml?aid=9456.

14. Ibid.

15. "EU Legislation Unnecessarily Complex," *EUobserver*, September 13, 2002, www.euobserer.com/index.phtml?aid=7541. See also "Enlargement Referenda—When—Where—Yes-or-No," *EUobserver,* December 18, 2002, www.euobserver.com/index.phtml? aid=8822.

16. "UK Chancellor to Demand More Flexibility," *EUobserver*, March 10, 2003, www.euobserver.com/index.phtml?aid=10481.

17. Ibid.

18. "Klaus: Vstup Do EU Moc Nezmeni," *Lidove Noviny*, November 12, 2002, www.lidovky.cz/clanekzahranicni.asp?r=zahranicni&c=A021112_143736_zahranicni_lvv.

19. Directorate General for Economic and Financial Affairs of the EU, "The Economic Impact of Enlargement," *Enlargement Papers*, no. 4, June 2001.

20. Anders Aslund, *Building Capitalism: The Transformation of the Former Soviet Bloc* (Cambridge: Cambridge University Press, 2002).

21. Ibid.

22. Ibid., p.110.

23. James Gwartney and Robert Lawson, *Economic Freedom of the World: 2003 Annual Report* (Vancouver: Fraser Institute, 2003), p. 11.

24. Quoted in Aslund, p. 143.

25. Ibid., p. 117.

26. Leszek Balzerowicz, *Post-Communist Transition: Some Lessons* (London: IEA, 2001), pp. 35–36.

27. Aslund, p. 119.

28. Balzerowicz, p. 37.

29. Aslund, p. 120.

30. Ibid., p. 115.

31. World Bank, "World Development Indicators 2002," www.worldbank.org.

32. European Bank for Reconstruction and Development, "2002 Transition Report," www.ebrd.com/country/index.htm.

33. Aslund, p. 445.

34. Richard Corbett, "A Lot Done, a Lot More to Do—Labour and European Social Legislation," Fabian Society, October 8, 2002, www.fabian-society.org.uk/documents/ViewADocument.asp?ID=63&CatID=52.

35. See directives 96/34/EC and 2001/25/EC.

36. See directives 2002/15/EC and 2000/79/EC.

37. Employees can choose to work more if they want to.

38. See directive 93/104/EC.

39. See directive 2002/44/EC.

40. See directive 2002/44/EC.

41. World Bank, "Hungary on the Road to the European Union," 1999, pp. 141–43, www.wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2000/03/21/000094946_00022505304322/Rendered/PDF/multi_page.pdf.

42. EU Commission, "Employment and Social Policy," http://europa.eu.int/comm/enlargment/negotiations/chapters/chap13/index.htm.

43. EU Commission, "Protocol on Social Policy," http://europa.eu.int/abc/obj/treaties/en/entr8i.htm.

44. See directive 89/391/EEC.

45. See directive 2002/44/EC.

46. EU Commission, "Employment," http://europa.eu.int/comm/enlargement/faq/#Employment.

47. Bernhard Seliger, "Unemployment, the One Lasting Problem," *Central Europe Review*, February 5, 2002, www.ce-review.org/01/5/seliger 5.html.

48. Quoted in Peter Hansen, "Estonian Wages Hardly to Rise in the EU," http://manila.djh.dk/EUestonia/stories/storyreader$53.

49. Szamuely and Jamieson, p. 51.

50. "A Survey of Germany," *The Economist*, December 7, 2002.

51. "Commission Starts Recruitment Search in Accession Countries," *EUobserver*, February 19, 2003, www.euobserver.com/index.phtml?aid= 9438.

52. EU Commission, "2002 Regular Report on Hungary's Progress towards Accession," http://europa.eu.int/comm/enlargement/report2002/hu_en.pdf.

53. EU Commission, "2002 Regular Report on Czech Republic's Progress towards Accession," http://europa.eu.int/comm/enlargement/report2002/cz_en.pdf.

54. EU Commission, "Environment," http://europa.eu.int/comm/enlargement/negotiations/chapters/chap22/index.htm.

55. See directive 92/3/Euratom.

56. See directives 2002/740/EC, 98/483/EC, and 2002/747/EC.

57. See directive 2001/720/EC.

58. See directives 91/676/EEC, 98/83/EC, 80/68/EEC, 79/869/EEC, and 76/160/EEC.

59. See directives 2001/81/EC, 2001/80/EC,, 88/77/EEC, and 2278/1999/EEC.

60. See directives 75/442/EEC, 91/689/EEC, and 78/319/EEC.

61. EU Commission, "2002 Regular Report on Czech Republic's Progress towards Accession."

62. EU Commission, "Environment," http://europa.eu.int/comm/enlargement/negotiations/chapters/chap22/index.htm.

63. Organization for Economic Cooperation and Development, "Globalization and Environment: Perspectives from OECD and Dynamic Non-member Economies," 1998, p. 20.

64. See Daniel Griswold, "Trade, Labor, and the Environment: How Blue and Green Sanctions Threaten Higher Standards," Cato Institute Trade Policy Analysis no. 15, August 2. 2001, p. 9.

65. Ibid.

66. EU Commission, "Environment," http://europa.eu.int/comm/enlargement/faq/faq2.htm#Environment.

67. William Rees-Mogg, "A Bumpy Ride for the EU's Poorest Passengers," *London Times*, November 25, 2002, www.timesonline.co.uk/article/0,482-491711,00.html.

68. Roger Bate, "Progress Report," TechCentral Station, July 7, 2003, www.techcentralstation.com/1051/printer.jsp?CID=1051-070203D.

69. Bengt Karlsson, "What Price Enlargement? Implications of an Expanded EU," Expert Group on Public Finance, 2002, www.finans.regeringen.se/eso/PDF/ds2002_52e.pdf.

70. "Negotiations on the Agriculture Chapter," Slovak Radio, www.slovakradio.sk/rsi/ang/business/txt/2506_hospodarstvo2.html.

71. EU Commission, "Enlargement and Agriculture: A Fair and Tailor-Made Package Which Benefits Farmers in Accession Countries," http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=MEMO/02/301|0|RAPID&lg=EN&display=.

72. Szamuely and Jamieson, pp. 27–28.

73. Ibid., p. 73.

74. EU Commission, "Agriculture," http://europa.eu.int/comm/enlargement/faq/faq2.htm#Agriculture.

75. "Europe Is Our Future, Hungary Is Our Homeland," Fidesz Integration Programme, December 7, 2002.

76. See directives 2561/1999, 1538/91, and 1906/90.

77. See directive 1221/97.

78. EU Commission, "Agriculture."

79. "Pre EÚ je rozšírenie krokom do tmy," *SME*, November 6, 2002, www.sme.sk/clanok.asp?cl=718191.

80. James Glassman, "Elite Hypocrisy," TechCentral Station, February 10, 2003, www.techcentralstation.be/2051/wrapper.jsp?PID=2051-100&CID=2051-021003M. See also Ronald Bailey, "The

Looming Trade War over Plant Biotechnology," Cato Institute Trade Policy Analysis no. 18, August 1, 2002.

81. World Bank, 'Europe and Central Asia: Regional Overview," http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20040935~menuPK:34480~pagePK:36694~piPK:116742~theSitePK:4607,00.html.

82. "Vlani Sme Predbehli Europu," *SME*, March 14, 2003, www.sme.sk/clanok_tlac.asp?cl=840 484; and "Schröder to Pump 15bn into German Economy," *London Times*, March 14, 2003, www.timesonline.co.uk/article/0,,1-610721, 00.html.

83. World Bank, Country Statistics, www.worldbank.org/data/countrydata/countrydata.html.

84. Karl Zinsmeister, "Old and in the Way," *American Enterprise*, December 2002, pp. 4–9.

85. Richard Miniter, "Economics and Politics in Today's Europe," *American Enterprise*, December 2002, pp. 36–39.

86. Zinsmeister, pp. 4–9.

87. Ibid.; and José Piñera, *Liberating Workers: The World Pension Revolution*, Cato's Letters, no. 15 (Washington: Cato Institute, 2001) pp. 11–12.

88. "Renteralter bis 2030 auf 67 Jahre anheben," *Frankfurter Algemeine Zeitung*, November 14, 2002, www.faz.net.

89. See Ambrose Evans-Pritchard, "Whistle-blower Admits Defeat on EU Corruption," *Telegraph*, August 27, 2002, www.telegraph.co.uk/news/main.jhtml?xml=/news/2002/08/27/wblow27.xml.

90. Quoted in Ian Black and Michael White, "EU Safeguards Worse Than Enron's, Accountant Says," *Guardian*, August, 2, 2002, http://politics.guardian.co.uk/eu/story/0,9061,768094,00.html.

91. David Landes, *The Wealth and Poverty of Nations* (London: Little, Brown, 1998), p. 36.

92. Václav Klaus, *Renaissance: The Rebirth of Liberty in the Heart of Europe* (Washington: Cato Institute, 1997), p. 113.

93. Quoted in Chris Edwards and Veronique De Rugy, "International Tax Competition: A 21st-Century Restraint on Government," Cato Institute Policy Analysis no. 431, April 12, 2002, p. 21.

94. Benjamin Powell, "Economic Freedom and Growth: The Case of the Celtic Tiger," *Cato Journal* 22, no. 3 (2003): 436–37.

95. Sally.

96. "Europe Is Our Future, Hungary Is Our Homeland."

97. "Big Countries Defend Franco-German Proposals," *EUobserver*, January 22, 2003, www.euobserver.com/index.phtml?aid=9096.

98. See the full text of the European Constitution at http://european-convention.eu.int/bienvenue.asp?lang=EN.

99. EU Commission, "Employment."

100. Personal communication, March 2003.

Published by the Cato Institute, Policy Analysis is a regular series evaluating government policies and offering proposals for reform. Nothing in Policy Analysis should be construed as necessarily reflecting the views of the Cato Institute or as an attempt to aid or hinder the passage of any bill before congress. Contact the Cato Institute for reprint permission. Additional copies of Policy Analysis are $6.00 each ($3.00 each for five or more). To order, or for a complete listing of available studies, write the Cato Institute, 1000 Massachusetts Ave., N.W., Washington, D.C. 20001, call toll free 1-800-767-1241 (noon - 9 p.m. eastern time), fax (202) 842-3490, or visit our website at www.cato.org.