1 INTRODUCTION

Any European state which respects the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law may apply to become member of the European Union [Article 49 in combination with Article 6(1) of the Treaty on European Union, 2 October 1997].

Since the signing of the treaty of Rome in 1957 and the establishment of the European Community (EC), enlargement has always been a crucial step in the shaping of a reconciled, peaceful and democratic Europe. After the fall of the iron curtain the Central and Eastern European Countries (CEEC) were given a clear perspective for joining the European Union (EU). Since then, the EU as well as the CEEC have been continuously working towards the accomplishment of the unification of Europe.

1.1 HISTORICAL OVERVIEW

The Association Agreements, which came into power on 1 March 1992, contained extensive co-operation measures in fields such as trade, environment, crime, financial assistance and the political dialogue. They were signed between the EU and Bulgaria, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, the Czech Republic and Hungary. Their aim was the economic and political preparation for full future accession of the CEEC to the EU.

In Copenhagen the European Council officially defined the so-called "Copenhagen criteria" in June 1993 which applicants would have to meet in order to become members of the EU. These were:

- democracy, the rule of law, human rights and the protection of minorities;
- a functioning market economy, and an ability to cope with competitive pressures within the Single Market;
- ability to accept the obligations of membership, including the rules and laws known as the acquis, a body of law with some 20'000 pieces of legislation.

Between 1994-96 all ten CEEC handed in their actual application requests. In December 1997 the European Council officially opened the enlargement process towards central and eastern Europe (CEE). Although all talks have been undertaken individually, all applicants have been taking part in this process with the same prerequisites and rights. The motto of the proceeding has therefore been: Differentiation without discrimination.

The decision of the European Council in Luxembourg in December 1997 to put in place

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1 This treaty is better known as "Treaty of Amsterdam".

2 They were also called "Europe Agreements".
a multilateral committee for political consultations, called the "Europe Conference" between the EU and all actual or potential applicants was aimed at further intensifying integration.

Current accession negotiations started in March 1998, at first only with Poland, Hungary, the Czech Republic, Estonia and Slovenia.\(^3\) Up to now 23 of a total of 31 chapters have been dealt with. Depending on the country, preliminary agreements have been achieved in eight to eleven chapters. Due to requests for interim regulations, accord in the other chapters has been postponed.\(^4\) Talks regarding the remaining eight chapters are expected to start in the first six months of 2000. The most difficult chapters on agriculture, labour mobility, environment, and regional policy have not been dealt with yet and are likely to be controversial.

In December 1999 the European Council in Helsinki decided that negotiations with all other CEEC should soon commence. On 15 February 2000 negotiations at ministerial level started with Bulgaria, Latvia, Lithuania, Romania and Slovakia (as well as Malta).

The EU has been strongly supporting the accession efforts of the CEEC. Within the context of the PHARE-programme between 1989-98 all in all 8.8 billion euros have been put at CEEC' disposal in order to build an effective administration and undertake investments for the implementation of the acquis. In March 1999 the European Council in Berlin implemented additional instruments in the areas agriculture and structural policy in order to lead the CEEC to EU standards. For the period 2000-06 financial resources of 21.84 billion euros (including PHARE) are ready to assist CEEC' accession endeavours.

The EU itself is forced to carry out institutional reforms before new members can actually be admitted. The agreement on the Agenda 2000 (the financial framework for the years 2000-06) at the European Council in Berlin in March 1999 has been an important step in that direction, although further budgetary reforms seem to be necessary.\(^5\) Additionally a governmental conference was held on 14 February 2000 with the aim of defining all required institutional reforms. It is supposed to conclude in December 2000. The aim is to pass a new Treaty on European Union in order to enable eastern enlargement. Amongst other things, issues such as a different distribution of votes and an expansion of majority voting in the European Council, as well as a changed number of commissioners per country have to be tackled.

\(^3\) The EU also started official accession negotiations with Cyprus.

\(^4\) CEEC' aspirations for temporary protective tariffs for agricultural goods and large production quotas have been reported to encounter strong resistance from the European Commission. See FAZ (2000).

\(^5\) The reduction of EU's budget and particularly the required reform of agricultural transfer payments turned out to be much more moderate than originally intended. Germany's foreign minister Fischer commented on this fact by saying that further reforms would be necessary before enlargement could take place (see Pawlovsky 1999).
1.2 PROBLEM AND OBJECTIVE

The issue of the eastern enlargement of the EU is the subject of much heated debate in contemporary political discussions within Europe. Firstly, there is a debate between authorities from both, the EU and the CEEC in the context of official accession negotiations. The pace of integration, the fulfilment of the necessary prerequisites and the specification of interim regulations are the main topics of this discussion. Secondly, there are controversial debates within each of the two regions concerned. In the CEEC, on the one hand, there are fears about a lack of competitiveness of their products and the emigration of highly skilled workers to the detriment of the domestic economies. In the EU, on the other hand, worries are frequently articulated about excessive costs of enlargement and a large inflow of foreigners. Hence, the mobility of workers from East to West is an issue which deeply concerns people on both sides of the borders. Sometimes even the whole issue of eastern enlargement of the EU is questioned; a debate which is pointless since it ignores both, the philosophy of the European Union (see Article 49) and the actual steps that have already been undertaken. Therefore, today's question no longer concerns whether or not the CEEC should join the EU, but rather when enlargement should take place and with what interim regulations.

The problem of the controversies in the enlargement discussion is that some of the arguments specifically make use of fears and emotions of the citizens without providing scientific proof for the "horror scenarios". The outlined size of migration flows between East and West as well as the consequences of CEEC' integration are then often depicted in exaggerated form. But apart from such polemics, it is difficult to objectively assess the effects of an eastern enlargement. Some theoretical studies can expound the general tendencies we ought to expect. Their disadvantage is that they cannot specifically quantify the potential effects. Thus, the empirical part is missing in such papers. Other analyses, although empirical, concentrate on one particular market or subject, assuming that all other markets remain unchanged. These evaluations do not allow for interdependencies and cross effects in an economy.

This paper considers these handicaps by combining an empirical study with a special consideration of the whole economy.

The objective of the present study is an assessment of the consequences resulting from deeper forms of economic integration between the CEEC and the EU using a computable general equilibrium (CGE) model. In doing so, we attach particular emphasis to the issue of labour mobility by specifically estimating important migration parameters. Thus, our aim is to contribute to the prevailing discussion by presenting numerical results derived from both econometric estimates as well as simulations from a CGE-model. Specifically, two questions shall be answered:

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1. What will be the potential extent of (net) migration between the CEEC and the EU once free mobility of labour is allowed?

2. Which macroeconomics effects will further integration of the CEEC to the EU have on both economies?

In the context of question 2 we will specifically study the consequences of (i) further trade integration, (ii) official capital transfers from the EU to the CEEC and, based on the results of question 1, (iii) labour migration from the CEEC to the EU.

**Aggregating the CEEC, Wise or Pointless?**

As mentioned, the EU deals with each applicant from CEE according to the motto *differentiation without discrimination*. Thus, officially an individualistic approach is being applied. In our study, in contrast, the CEEC are mostly treated in an aggregated manner. Economic arguments, however, tend to question such an approach. After all, the CEEC are anything but one big integrated, homogeneous economic area. Most of these countries have interacted with each other and with the EU in a way which encouraged Baldwin (1994) to compare it to a "hub and spokes" system implying a very low degree of integration among the CEEC (the spokes). Also their economic performance followed a rather divergent pattern.

Nevertheless, besides the argument of pure practicability for the quantitative analysis, there are also economic and political reasons why an aggregation might be sensible. Firstly, there are assimilation tendencies among the CEEC. Important steps towards greater economic and political integration have, for instance, been undertaken by the members of the *Visegrad Group* which constitutes a large share of the CEEC. Also in terms of economic and political transition, the CEEC are already rather homogeneous or are clearly converging. EBRD's *Transition Indicators* registered the greatest progress of reforms in south-eastern European countries like Bulgaria and Romania which formerly lagged behind.

Secondly, the articulation of the political attitude and goals of individual CEEC strongly resemble each other: each actual and potential applicant from CEE has emphasised its intention to become a full member of the EU as soon as possible. Also from the viewpoint of the EU there has been a considerable change towards a more equal treatment of the CEE candidates since the Tampere summit in October 1999. It expressed its will to carry out accession negotiations with all CEEC rather than with the one privileged group of six. The Economist (1999) interpreted this change as a more political and strategic view of enlargement, departing from the track of solely focusing on economic criteria. Hence, an enlargement scenario including more than only six CEEC becomes more and more probable.

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7 The Czech and Slovak Republic, Hungary and Poland form the so-called "Visegrad Group" (founded in 1991) which is a policy co-ordinating institution. From it emerged the Central and Eastern European Free Trade Agreement (CEFTA) on 1 March 1993.

1.3 CONTENTS, STRUCTURE AND METHODOLOGY

The remainder of this paper is organised as follows: the second chapter will introduce the concept of different approaches to general equilibrium modelling and explain the main assumptions contained in our approach. An introduction to the treatment of data and the procedure of calibration will be given. The third chapter will acquaint the reader with the computable general equilibrium model and the data which we use for our evaluations. A static as well as a recursive dynamic model assuming constant returns to scale and perfect competition is being applied for our simulations.

Due to the particular attention which we devote to the issue of labour mobility, the fourth chapter will specifically focus on the question of how much free migration would come about if the EU and the CEEC formed a common market. Using the example of the Southern enlargement of the EC towards Greece, Portugal and Spain in the 1980s, we derive a potential East-West migration pattern by undertaking both, a descriptive as well as a pooled time series, cross-sectional econometric analysis. In particular, the estimated migration coefficients will be used in the CGE-model with the aim of evaluating the consequences of integration at a later stage.

Chapter five then presents the different policy experiments, discusses expectations as well as simulation results. Initially the integration experiments will be simulated individually before being combined into a synthesising analysis. Chapter six will eventually summarise and conclude the main findings of this thesis.