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EU enlargement and theories of economic integration

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EU enlargement and theories of economic integration

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The fifth wave of EU enlargement taking place in 2004 and 2007 was the culmination of a long process beginning in 1989. Early on the Central and Eastern Europe countries began requesting membership, taking the then European Community by surprise. Only slowly during the 1990s were criteria for accession drawn up and empirical studies of the likely effects of enlargement began to emerge. The theoretical basis for analysis of the enlargement process was heterogeneous and piecemeal, and it is difficult to talk of 'enlargement theory'. None the less the aim here is to indicate the main theoretical approaches used to study the fifth wave of enlargement.
A strand of integration theory relies on the seminal work of Balassa to synthesize this process into 'stages' or grades of integration: a free trade area; a customs union; a single market (with the four freedoms of movement of goods, services, capital and labour); economic and monetary union; and political union. Though these stages do not constitute clearly defined steps in an ascending scale, as will be shown here, they are reflected in the evolution of 'enlargement theory'. The paper illustrates that economic theories of enlargement and those dealing with more general aspects of European integration have at times developed in parallel, with spillovers occurring in both directions, but in other cases they have taken rather diverging routes.

KEYWORDS: European integration, EU enlargement, theories of integration

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1. Introduction

The fifth wave of EU enlargement taking place in 2004 and 2007 was the culmination of a long process beginning in 1989. Early on the Central and Eastern Europe countries (CEECs) began requesting membership, taking the then European Community by surprise. Only slowly during the 1990s were criteria for accession drawn up and empirical studies of the likely effects of enlargement began to emerge. The theoretical basis for analysis of the enlargement process was heterogeneous and piecemeal, and it is difficult to talk of 'enlargement theory'. None the less the aim here is to indicate the main theoretical approaches used to study the fifth wave of enlargement. The focus on 2004 and 2007 is justified not only by the scale of the enlargement and the amount of analysis it attracted, but also because (as will be shown) the theory used to analyse earlier enlargements is often difficult to distinguish from more general integration theory.

The elements of 'enlargement theory' identified here also have important implications for the ongoing widening process of the EU. Such approaches can and have been applied to future enlargements to the candidate countries (Croatia, the Former Yugoslav Republic of Macedonia, Iceland and Turkey) and other potential candidate countries that have applied for EU membership (the Western Balkan countries: Albania, Bosnia and Herzegovina, Kosovo under UN Security Resolution 1244, Montenegro and Serbia).

As EU integration has evolved from the early years centred mainly on trade and agriculture, so too have the economic theories attempting to explain the process. In addition to eliminating barriers to trade, new member states now have to join the single market, and take on the legal provisions and institutional structure to ensure its durability. They must participate in the Lisbon Process, subsequently revived as Europe 2020, which aims at creating jobs and growth. They are required to accept the ultimate objective of economic and monetary union with the co-ordination of economic policies this implies. They can benefit from support for economic and social cohesion from the EU budget, and participate in various policies such as those relating to agriculture, the environment, energy, transport and so on. Last, but not least, is the political dimension with participation in the EU decision-making process.

A strand of integration theory relies on the seminal work of Balassa (1961) to synthesize this process into 'stages' or grades of integration: a free trade area; a customs union; a single market (with the four freedoms of movement of goods, services, capital and labour); economic and monetary union; and political union.[1] Though these stages do not constitute clearly defined steps in an ascending scale, as will be shown here, they are reflected in the

[1] See Senior Nello (2009) for a discussion of these stages.

evolution of ‘enlargement theory’. As the concern here is with economic developments, political union is largely excluded from this discussion.

Given the multifaceted nature of the integration process, not surprisingly the term ‘economic theories of integration’ can be used to classify a wide and disparate body of literature. As will be illustrated here, economic theories of enlargement and those dealing with more general aspects of European integration have at times developed in parallel, with spillovers occurring in both directions. In other cases they have taken rather diverging routes.

Clearly for reasons of space, the analysis here cannot deal with all aspects of enlargement, and must inevitably be selective. The first major concern of studies of the fifth wave of enlargement was with trade. What would be the ‘normal’ level and structure of trade in Europe when barriers were eliminated? In analysing the process of trade liberalisation, one of the main approaches used was that of gravity models, and as will be shown in Section 2 below, these subsequently also experienced a boom in the general integration literature following surprising empirical results about how far a common currency could foster trade.

Section 3 discusses the accession criteria designed to assess whether a country is ready to join the EU. However, as will be argued here, the accession criteria are too vague and imprecise to provide a clear guide as to which country is ready to join the EU and when. The practice of EU enlargement diverges strongly from such prescriptions as the theory can offer.

Enlargement is not simply about trade, and an approach attempting to deal with the other implications of EU widening was the theory of clubs. This approach aims at illustrating how costs and benefits vary as the number of members of a ‘club’ such as the EU changes. In other words, as shown in Section 4, application of the theory of clubs involves addressing the problem of the optimal size of the EU and whether a particular country should join the EU or not. Section 5 indicates some of the main types of cost and benefit taken into account by this type of approach.

As shown in Section 6, application of the theory of clubs to enlargement has a parallel in the optimal currency area (OCA) literature aimed at assessing which member states should join economic and monetary union. Neither theory was sufficiently operational to be of much use at the time when initial choices were made about participants in the fifth wave of enlargement and the euro. Subsequently there have been huge developments in the OCA literature, and as the possibility of adopting the euro became a reality for some of the new member states OCA analysis was gradually also extended to them. In contrast the application of the theory of clubs to EU enlargement has remained largely embryonic. This probably reflects the fact that while

choices in both areas contain a strong political element, this is probably even more the case for enlargement. Conclusions are drawn in the final section.

2. Enlargement theory and trade

Much of the early economic literature on the fifth wave of enlargement involved predictions of the level and structure of trade between the candidate countries and EU. In particular, what would the 'normal' level of trade be had the division of Europe never occurred, and what future patterns of specialisation would emerge?

Between 1991 and 1996 the EU signed 'Europe Agreements' to promote co-operation and establish a free trade area with the 10 CEECs that later became member states.[2] The removal of tariffs on certain sensitive sectors such as steel, and textiles and clothing was slower, but by 1998 most restrictions on industrial products had been removed. The concessions granted for agriculture were less favourable than in other sectors, but by 2003 even agricultural trade was liberalized for products meeting EU standards. Thanks also to the Europe Agreements, the reorientation of the trade of the CEECs towards the EU was rapid, and by 2004 the EU accounted for 73 per cent of the trade of the new member states (rising to 76 per cent in 2007) a share similar to that of the old member states.[3]

Early theoretical analysis of economic integration relied on customs union theory to assess the so-called static effects of integration on welfare. This is based on the distinction made by Viner (1953) between trade creation and trade diversion.[4] At the risk of oversimplification, trade creation arises when domestic production is replaced by cheaper imports from a partner

[2] Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia.
The EU was due to implement a customs union with Cyprus by 2002, but this was overtaken by the speed of the enlargement process. The 1970 Association Agreement with Malta envisaged a customs union, but with the government of the Labour Party from 1971 this was not implemented. When the nationalist Party came to power in 1987 it preferred to press for membership of the Community rather than implementation of the customs union. Malta's membership application was frozen from 1996 till 1998 when the Labour Party again came to power. The EU introduced a customs union with Turkey in 1995. In most cases the EU adopts free trade areas rather than customs unions with candidate countries as implementation of the latter is more complex, requiring the partner country to take on the EU's hierarchy of trade preferences.

[3] The statistics here are taken from European Commission (2009).

[4] This type of theoretical approach was used in evaluating both the creation of the Community and successive enlargements, so that it is difficult to distinguish integration and enlargement theories as such. In the subsequent literature there was further refinement of the different static effects of integration. For example, external trade creation was said to arise when the faster growth of the integration unit led to higher imports from the rest of the world. Trade suppression may arise when creation of the customs union leads to production in one of the partners stopping and production shifting to the other partner, which had previously imported from the rest of the world.

country. Trade diversion involves low-cost imports from suppliers in third countries being replaced by more expensive imports from a partner country. It was generally assumed that integration would lead to a welfare gain because the positive effect of trade creation would exceed the possible negative effects of trade diversion.[5] In the fifth wave of enlargement, trade was not only strongly reoriented towards the EU well before enlargement, but EU tariffs towards the rest of the world were generally also lower than those of the acceding countries, so it was widely considered that there would be little trade diversion. After enlargement trade of the new member states with the rest of the world continued to expand confirming the view that trade diversion was limited (European Commission, 2009).

As a result of the Europe Agreements, a free trade area was in place before enlargement. For the CEECs, joining the EU meant moving from a free trade area to a customs union (by adopting the common commercial policy with its 'hierarchy' of trade preferences) and the single market.[6] Traditional integration (and enlargement) theory dealt mainly with the impact of creating a customs union so was not very suited to studying this development.

In analysing the expected level of CEEC-EU trade many authors opted for what are known as 'gravity models'.[7] The gravity model approach involves attempting to predict the level of bilateral trade flows on the basis of variables such as GDP, population, geographical distance, and preferential trading arrangements. Gravity models are often relatively successful in predicting trade flows between countries but have been criticized for lacking theoretical underpinnings. The estimated coefficients of the model may reflect unrelated developments occurring at the same time rather than integration effects.

Gravity models were initially developed by Tinbergen (1952), and early applications to the Community include those of Verdoorn and Schwartz (1972) and Aitken. (1973) The best known studies of this type applied to EU-CEEC trade include those of Wang and Winters (1992), Hamilton and Winters (1992), Baldwin (1994), Faini and Portes (1995), Wilhelmsson

[5] Various early empirical studies based on the customs union approach found the effects of integration surprisingly small. Though there are considerable variations in the results, in general the gains from creation of the Community were found to be in the order of 1–2 per cent of GDP (Harrop, 2000, p. 65). The reward seemed remarkably small for all the effort of creating and expanding the Community. As a result there was a questioning of the approach, and the emergence of the view that integration probably also involved dynamic effects such as increased competition, more scope to exploit economies of scale, increased transfer of technology and knowledge and so on. The institutional framework provided by a regional bloc such as the EU also offered the promise of promoting growth. The analysis of such effects evolved more in the context of studies of the 1992 single market project (see, for example, Emerson et al, 1989) rather than enlargement process. However, the prospect of such dynamic effects undoubtedly carried much weight with the CEECs.

[6] No permanent derogations from EU rules on the single market were permitted, though transitional arrangements from 6 months to 12 years were introduced for certain policies (see Senior Nello, 2009).

[7] An alternative approach in attempting to predict the 'normal' level of trade between the CEECs and EU was that based on historical patterns used by Collins and Rodrik (1991).

(2006) and various studies of the European Bank for Reconstruction and Development.[8] Gravity models were also used to analyse foreign direct investment (FDI) in the new nember states (see, for example Bevan and Estrin, 2004, Demekas et al, 2007 and Bellak, Leibrecht and Riedl, 2008).

The extensive use of gravity models in analysing the enlargement process may have encouraged their use in studying other aspects of integration by authors such as Frankel (1997), Soloaga and Winters (1999) and Kandogan (2005a). The popularity of the approach exploded following the pioneering work by Andy Rose who used gravity models to show how introducing a common currency appears to have encouraged trade growth.[9] Rose (2000) found that countries with the same legal tender have trade flows between each other on average 100 per cent higher than those between pairs of countries that are not members of a monetary union.[10] This result spawned a vast and growing literature. Rose (2002) considers 24 recent studies of the impact of currency unions on trade, and despite the differences in approach and coverage of the studies, all seem to confirm that currency unions have a positive impact on trade. In a review of the literature on the Rose effect, Baldwin (2005) found an effect of 50 per cent or more for smaller countries, which was lower than the initial results, but still substantial.

Another major concern before the fifth wave of EU enlargement was about the eventual structure of CEEC-EU trade.[11] This was fuelled by worries about the ability of the CEECs to compete on EU markets and about eventual patterns of specialisation. As will be shown below, again in this case there was a link to more general integration theory as similarity of production and trade structures is generally considered a precondition for the successful pursuit of integration also in the area of economic and monetary union.

The literature on enlargement also sheds light on the debate over whether regional trade blocs are building blocks or stumbling blocks in the process of multilateral trade liberalisation. In his various publications on both the 1995 and Eastern enlargements Richard Baldwin introduced the domino effect to argue that regional integration promotes worldwide trade liberalization.[12] According to this model, the preferential lowering of some trade barriers causes new pressures for outsiders to join, and as the trade bloc grows, the pressures to join

[8] See European Bank for Reconstruction and Development, Transition Report, various years.
[9] Frankel and Rose, 2000, and Rose (2000 and 2002).
[10] The Rose (2000) analysis was based on a cross-country dataset covering bilateral trade between 186 economic systems at five-year intervals using a linear gravity model. One of the surprising outcomes of Rose's study is that exchange rate volatility plays little significant role in the picture.
[11] See, for example, the studies by Hamilton and Winters (1992), Dràbek and Smith (1995), Eichengreen and Kohl (1998), or Kaitila and Widgrén (1999).
[12] See, for example, Baldwin (1993).

become bigger. Outsiders want to become insiders, increasing the incentives to add members to the integration bloc. This enlarges the market, causing other countries to be pulled in as well.

3. The Copenhagen criteria

The choice of which countries were deemed ready to join the EU was allegedly based on the Copenhagen criteria. The criteria were first drawn up for the CEEC countries at the 1993 Copenhagen European Council, but were subsequently extended to apply to all candidate countries and entail that:

- The applicant state must have a functioning market economy with the capacity to cope with competitive pressures and market forces within the Community;
- The applicant state must have achieved stability of institutions, guaranteeing democracy, the rule of law, human rights, and respect for and protection of minorities;
- The applicant state must be able to take on the obligations of membership, including adherence to the aims of political, and economic and monetary union.

At the Copenhagen Summit it was also stipulated that enlargement is subject to the condition that the EU is able to absorb new members and maintain the momentum of integration. Subsequently the EU stressed the requirement of adequate administrative and judicial capacity on the part of the candidate countries (at the Madrid European Council of 1995); indicated that the political criteria were predominant (for instance in the 1997 European Commission document, Agenda 2000, and the Treaty of Amsterdam); and emphasised the need for regional co-operation and good neighbourly relations.

Three economic criteria can be identified from the list above: the existence of a functioning market economy; capacity to cope with competitive pressures and market forces within the Community; and adherence to the aim of economic and monetary union.

It is difficult to discern any ‘economic theory of enlargement’ from these criteria. The criteria are presumably intended to provide some kind of objective basis for selecting countries ready to join the EU, as well as indicating to the applicant countries the tasks they were expected to perform. The insistence on a ‘functioning market economy’ reflects the concern at that time that transition in the CEECs should be sufficiently advanced.

The Copenhagen criteria seem aimed at replicating the experience of the EMU Maastricht criteria but in a different field, that of enlargement. However, although there is a certain flexibility and political leeway in deciding whether the Maastricht criteria have been met, this is far more the case for the accession criteria. This arises from the number of criteria and from the vague and imprecise nature of some of the concepts involved. This is the case, for instance, in deciding whether a country has a 'a functioning market economy' or the 'capacity to cope with competitive pressures'. There are different models of market economies, and no indication is given as to which model is appropriate, or how to assess when an economy has 'arrived'. In deciding whether a country is ready to cope with competitive pressures in an enlarged EU, a detailed analysis of its economy is necessary, together with predictions about which sectors would be able to cope in the internal EU market. The simple rule 'when a country meets the accession criteria, it can join the EU' is misleading given the degree of discretion in deciding whether the accession criteria have been met.

In the event very little selection was made on the basis of any of the Copenhagen criteria in the fifth wave of enlargement. Slovakia was singled out as not meeting the political criteria in Agenda 2000. The EU opted for a big bang enlargement in 2004, with the accession of only two countries being postponed until 2007 because they were not deemed ready. Aside from the shortcomings of the criteria, this would also seem to suggest economies of scale for the EU in adjusting its structures to new members (also because all the existing member states have to ratify any enlargement).

Turning to the application of the Copenhagen criteria to future enlargements, the European Commission repeatedly points to shortcomings in the ability of Turkey to meet the political criteria. Partly as a result of the experience of the 2007 enlargement greater emphasis is now placed on the need for candidate countries to combat crime and corruption effectively.[13] Increased weight also seems to be attached to the requirement of regional co-operation and good neighbourly relations before accession, possibly reflecting the unhappy experience of admitting a divided Cyprus to the EU, but also because many of the actual and potential candidates are former Yugoslav Republics. Once again economic considerations, let alone theories, seem to have been relegated to secondary importance.

[13] In Bulgaria and Romania a Special Co-operation and Verification Mechanism was set up to assist in reform of the judiciary and the fight against crime and corruption after accession.

4.The Economic Theory of Clubs

Though economic theory carried little weight in assessing whether countries were ready to join the EU, this does not imply it was absent from the literature. One approach to analysing the enlargement process was the economic theory of clubs.[14] Clubs are assumed to pursue a well-defined common interest. The problem is to determine the optimal number of members or size of the club, and this will entail defining the costs and benefits of increasing membership. For simplicity it is often assumed that clubs provide goods and services for their members, which are intermediate between private and public goods in that the clubs supply a product that is excludable (like a private good) but non-rival (as in the case of a public good). However, it is debatable how far the various common EU policies are non-rival (as for instance in the case of the common fisheries policy)[15] or even in some cases excludable (for example, non-EU members have been able to share in the benefits of adopting common standards). It is probably more realistic to assume that the club supplies a semi-public or congestion good, with marginal cost eventually increasing as the number of members rises.

For simplicity, the members of the club are assumed to be identical, so the marginal costs and marginal benefits of an additional member to existing members can be depicted in a single diagram like Figure 1. If every member is different a separate axis for the marginal costs and benefits of each member is necessary.

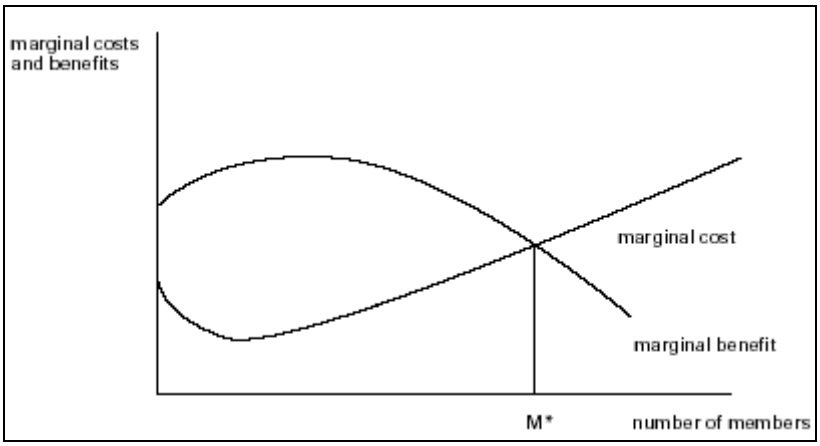
The optimal number of members of the club M* occurs where the curves indicating marginal costs and marginal benefits to existing members (who are also responsible for deciding on the admission of new members) intersect.

The benefits of membership include, for instance, the right to be a member of the EU and to participate in common policies such as the single market, EMU, economic and social cohesion and the CAP. Starting with a small number of members in the literature the benefits to incumbents are often assumed to rise initially as membership increases, but eventually decline as congestion grows (implying a decline in the benefits both to new and existing members). This causes the marginal benefit curve to take the form shown in Figure 1.

[14] See Mueller (2001) for a discussion of this theory, which was initially elaborated by Buchanan (1965). For an application to EU enlargement see Gros and Steinherr (2004), De Benedictis and Padoan (1994), or Alesina and Spolaore (2003). For the latter authors, benefits may come from economies of scale and costs from increasing heterogeneity of preferences.

[15] For a discussion of this issue see Senior Nello (2009)

Figure 1 Costs and benefits to existing club members of expanding membership



For simplicity it is assumed that the total cost of providing these policies is fixed, that the members are identical, and costs are shared equally. As the number of members increases, each new member will bear a share of the total cost, but the share will gradually decrease as more members are added. The cost to existing members also declines initially as membership increases, but in the literature is generally assumed to rise eventually. The increase in marginal costs is also the result of congestion (and the increased difficulty of reaching agreement among more numerous members with more heterogeneous preferences), and of sacrificing sovereignty.

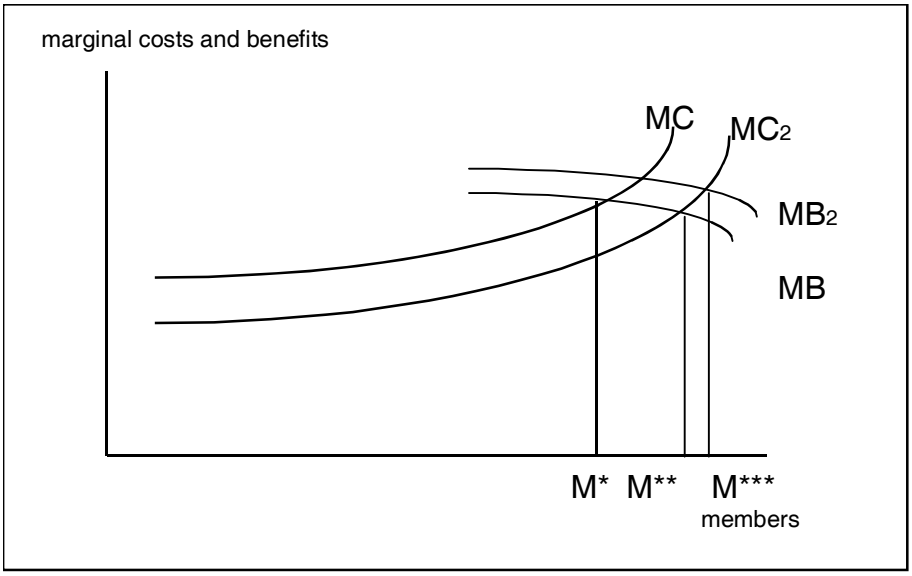
Changes in EU policies and institutions can be introduced to alter both the marginal costs and benefits. The countries joining the EU might be required to introduce changes in policies and practices (as requested by Agenda 2000, and the pre-accession strategy) that have the effect of shifting the marginal cost curve down. For instance, the accession countries were required to improve their administrative and judicial practices. As shown in Figure 2, the effect could be to shift the marginal cost curve to MC2 so the new optimal size of the club becomes M**. At the same time the EU could (and did) introduce policy changes such as CAP reform to shift the marginal benefits curve higher. In Figure 2 this could be shown by the new marginal benefit curve MB2 so the new equilibrium becomes M***.

The Amsterdam, Nice and Lisbon Treaties all increased the use of qualified majority voting in the Council of Ministers with a view to avoiding deadlock in decision-making in an enlarged EU. In terms of Figure 2, the aim was to shift the MC curve down.[16] However, even after

[16] As Baldwin and Wyplosz (2009) argue, it is the Council rather than the European Parliament (EP), which is decisive for the balance of power between EU member states in EU decision-making, both because the distribution of voting power by member state is similar in the EP and Council, but also because the simple majority threshold in the EP for most questions is lower than that of the Council.

enlargement the practice of generally trying to reach consensus continued, so the costs in time and concessions necessary to reach agreements probably increased. The three treaties also extended use of the co-decision procedure, and the Lisbon Treaty envisaged near generalization of its use so that it became known as the ordinary legislative procedure. This increases the role of the European Parliament, which also became subject to a growing number of lobbying activities. While more use of the co-decision procedure was aimed at reducing the democratic deficit of the EU, it probably also raised the time, effort and concessions needed to reach agreement.

Figure 2 Shifts in the marginal costs and benefits of enlargement



The picture is even more complex in that it is necessary to consider not only the costs and benefits at the time of enlargement, but also constellations of bargaining power and formal decision-making rules over time. These may enable a net loser at the time of enlargement to ensure a guarantee of compensation at a later stage from the winners (Schimmelfennig and Sedelmeier, 2005). What then becomes decisive in the accession negotiations is the voting power of the country in the Council and EP.[17]

As applied to EU enlargement the theory of clubs raises interesting questions, but (as is confirmed by the following section) it is difficult to apply in practice. For instance, its

[17] Kandogan (2005b) and Baldwin and Wyplosz (2009) find a distinct positive relation between the per capita vote shares of EU member states in the Council and their share in expenditure from the EU budget Kandogan (2000) also finds a close link between the voting weight of countries with a strong interest in agriculture and agricultural spending from the EU budget.

application by authors such as Gros and Steinherr (2004) suggests that the net advantages of membership were greatest for the early members of the Community, but fell as more members were added. However, it is difficult to identify the various costs and benefits as a result of EU enlargement, or to give weights to them, and the shape and position of the marginal cost and benefits curves are not known with any precision. The members and potential members are clearly not identical, so separate analyses would have to be carried out for individual member states and potential candidates. The following section tries to indicate some of the costs and benefits of enlargement identified in the empirical literature on the economics of EU enlargement.

5. Empirical estimation of the costs and benefits of EU enlargement

A detailed survey of the economic literature attempting to assess the costs and benefits of enlargement is beyond the present scope, but the aim of this section is to give a brief indication of some of the approaches used.

A first distinction is between the visible costs and benefits that appear in the EU budget and the more general economic effects of EU enlargement.

With regard to the EU budget, for the period 2004-2006 the 2002 Copenhagen European Council earmarked €40.9 billion in expenditure for the 10 acceding countries (about 2.3 per cent of their GDP). In 2007 the net transfer to the new member states (EU(12)) was about 17.8 billion representing about 2.1 per cent of their GDP and this is expected to rise to 3 per cent of GDP by 2013.[18] This transfer represents a burden of 0.2 per cent of the GDP for the old member states (EU(15)) and the burden is predicted to rise to 0.3 per cent by 2013. Since accession the contribution of the new member states to the EU budget has been somewhat less than 1 per cent of GDP, in line with the contribution of the EU(15).

Turning to the wider picture, Table 1 summarises the results of various empirical studies of the economic impact of enlargement. The approaches used in the studies summarized in Table 1 were eclectic, and relied on a wide variety of methodologies, with many using general equilibrium models. A common conclusion was that enlargement would lead to large net benefits for the EU as a whole, in particular for the new member states.[19] Among the benefits from enlargement that emerge from these studies are intensified trade and FDI, lower risk

[18] The statistics on receipts and contributions to the EU budget are taken from European Commission (2009), which also attempts to estimate the impact of transfers from the EU budget on the economies of these countries. See Brenton and Gros (1993) for an early attempt to assess the budgetary implications of enlargement.
[19] See European Commission (2009) for a discussion of these studies.

premiums, macroeconomic stability, an improved framework for economic governance, and structural reforms induced by the prospect of EU membership.

Participation in the single market with the four freedoms (of movement of goods, services, capital and labour) was a central element in assessing the impact of enlargement. It was feared that this might also imply costs of enlargement (other than those directly reflected in the EU budget), with winners and losers in the process, and particular types of workers, production, or regions losing out.

The vast and expanding literature on the impact of labour movement in an enlarged EU generally attempts to assess the costs as well as benefits. A detailed discussion of the issue is beyond the present scope, but Brücker et al (2009) provide a truly extensive survey of the literature. They find most studies suggest an overall gain of between 0.1 and 0.5 per cent of GDP as a result of labour movement in an enlarged EU. Results vary according to the time period considered, the expected future migration flows, and assumptions about the skill mix of workers (see also some of the studies presented in Table 1). In the receiving countries many studies (such as Brücker et al (2009) and Kahanec and Zimmermann (2009)) found a slight decline in the wages of manual and non-manual workers and a slight increase in unemployment, but maintained that post-enlargement intra-EU mobility flows had not led to serious labour market disturbances. In the source country of the migrants all the results indicated gains for labour, though some found evidence for GDP declines even though capital deepening had induced increases in real wages and productivity (European Commission, 2009).

Table 1 Pre-enlargement empirical studies of the potential economic impact of enlargement

Study	**method**	**Area covered**	**Results: variable**	**Results: impact**	**period**	**remarks**
Baldwin, Francois and Portes (1997)	General equilibrium model	EU(15) CEEC(7) EU(15)	GDP GDP Public finance	+0.2% +1.5-18.8% -0.2% GDP	Steady state Steady state 1999	Germany and Austria benefit more. Lower risk premium explains higher result Enlargement to CZ, HU, PL, SL and SK
Breuss (2002)	World macroecon. model	13 of EU(15) HU, PL CZ	GDP	+0.5% +8%/9% +5%/6%	2005-2010 2001-2010 2001-2010	For ES, PT, DK the costs exceed the benefits
European Commission (2001)	Growth accounting analysis	AC (8)* CEEC(10) EU(15)	GDP growth	1.3%/2.1% +1%/1.8% =.5%7=.7%	1994-2009 annual cumulative	Central/optimistic scenario. Significant impact

						in new member states, modest in EU(15).
Grassini, Bardazzi and Missale (2001).	Multi-sectoral model	Italy	GDP Imports exports	+0.5% +0.6% +1.2%	2000-2010	Specialisation scenario reported Spill-overs double the impact
Heijdra, Keuschnigg and Kohler (2004)	General equilibrium model	EU(15)	Overall welfare as % GDP	+0.3%	Steady state	Trade, budgetary costs and migration effects are considered.
Kohler (2004)		Individual EU(15) countries	Overall welfare as % GDP	+2.0% AT/-0.1.3% PT	Steady state	Negative effect on PT, EL, IE and ES.
Keuschnigg and Kohler (2002)	Calibrated general equilibrium model	Austria	GDP Contribution to EU budget Exports Consumption wages	+0.6% +1.6% of GDP +15.9% +0.7% +0.5%	Long run scenario is reported.	Fiscal position improves despite higher net contributions to EU. Expected wage spread constant. Only immigration of unskilled may widen wage spread.
Keuschnigg, Keuschnigg and Kohler (2001)	Calibrated general equilibrium model	Germany	GDP Exports Wage income Skilled and unskilled wage	+0.5% 46.7% 0.5% 0.6%	Long run scenario is reported.	Investment-led expansion. Expanded activity swells the tax base. Some potential for adverse redistributive effects.
Kristensen, Rørmose Jensen (2001)	Structural dynamic macroeconomic model of the Danish economy (ADAM).	Denmark	GDP exports Imports GDP Investment Employment Wage rate	-0.5% +0.6% -0.6 +1.4% +1.3% +1.3% -0.8%	2000-2010 2000-2065 scenario of neutralised budget effect	In the long run positive effects from immigration and productivity outweigh short-term costs
Lejour, de Mooij and Nahuis (2001)	General equilibrium model WorldScan	EU(15) CEEC(7)	Welfare effects as % GDP	+0.1/0.6% +5.3/-1.8%	Long run	Single market/labour migration
Maliszewska (2004)	General equilibrium model	EU(15) Hungary Poland	Welfare effects of trade liberalisation as % GDP	+0.03% +7% +3.4%	Long run	Base scenario

*Appicant countries

Source: European Commission (2009).

Turning to capital movement, many studies emphasise the overall positive role played by FDI and outward processing trade (or the international fragmentation of the production process) in the enlargement process.[20] Benefits include the stimulation of investment, exports and employment as well as knowledge spill-overs, better organisation, competition and improved quality and variety of products. FDI was also considered to offer opportunities to the EU(15) to increase global competitiveness by exploiting complementarities.

With regards to costs to the EU(15) because of relocation of industry, the literature finds that results differ according to sector. For example, European Commission (2009) finds that employment in the old member states is negatively correlated with the rise in employment as a result of FDI in some sectors (food, clothing, publishing, communication equipment, office machinery and vehicles), while the reverse is true for other sectors (machinery, furniture, medical instruments, chemicals and tobacco). With the economic crisis since 2007 fears of negative correlation have grown in the EU(15), while certain new member states have expressed concern at vulnerability because some sectors such as banking are so extensively foreign owned.

6. Parallels between the theories of enlargement and of economic and monetary union

Early theoretical assessments of whether countries should join together to form an economic and monetary union (EMU) generally make use of the concept of an optimum currency area.[21] A currency area may be defined as a group of countries that maintain their separate currencies but fix the exchange rates between themselves permanently. They also maintain full convertibility among their currencies and flexible exchange rates towards third countries. Alternatively, the member states may adopt a common currency, which floats against third currencies. The problem then becomes determining the optimum size of the currency area and, more specifically, deciding whether it is to the advantage of a particular country to enter or remain in a currency area.

A key issue in creating or joining a currency area is that autonomy of monetary policy (including ability to change the exchange rate) is foregone. According to economic textbooks, the role of the exchange rate mechanism is to act as a shock absorber in the event of asymmetric shocks, i.e. disturbances that affect the countries involved in different ways. The literature indicates three main criteria for creating or joining a currency area. The criterion

[20] See European Commission (2009) for a survey of these studies.
[21] This concept was introduced by Mundell in 1961.

based on the seminal work by Mundell (1961) suggests that labour mobility can help to alleviate the effects of asymmetric shocks when the exchange rate cannot be adjusted. A second criterion of 'openness' was initially proposed by McKinnon (1963) and is based on the idea that the exchange rate will be of little use if countries are very open. A third criterion is derived from the insight of Kenen (1969) that countries producing and trading a wide range of similar products are less likely to face asymmetric shocks.

On the supply side Krugman (1993) qualified the McKinnon criterion that trade openness would lead to more synchronous business cycles, arguing that this was only the case to the extent that there is intra-industry trade. Inter-industry trade would favour specialisation so would be likely to render cycles less synchronised. The analysis of trade openness in this context therefore has to be complemented by assessment of economic structures and the quality of trade flows.

The three criteria were instrumental in rendering the OCA approach operational, though this was not yet the case in the early stages of adopting the euro when OCA theory played little practical role. Later it became more important in monitoring the progress of EMU. The first articulated study of the optimal currency approach was carried out by the European Commission document 'One Money, One Market' of 1991. Later studies include those of Bayoumi and Eichengreen (1997) and Korhonen and Fidrmuc (2001). The five tests developed by the UK to decide whether to join the euro also owe much to OCA theory.[22]

There is a parallel between the analysis of whether a country is ready to join a currency union and whether it should join a regional bloc such as the EU. As discussed above, analysis of the CEECs was concerned with the level and structure of trade with the EU, and like the OCA approach, makes use of the concepts of trade openness and similarity of trade and production.

As the prospect of joining the euro became more immediate at least for some of the new member states, some later studies deal explicitly with the question of synchronisation between old and new member states (see Dandashly et al (2009)). For instance, European Commission (2009) confirms earlier studies in finding that similarity of trade patterns, monetary policy and to a lesser extent, fiscal policy and financial integration were important in explaining why some member states were better synchronised than others with the EU(15) thereby facilitating

[22] In 2003 an assessment of whether the UK should join the euro was taken on the basis of five economic tests: convergence of business cycles and economic; flexibility; investment; the City of London; and stability, growth and employment. The report maintained that the convergence and flexibility conditions were not satisfied so in consequence also the condition of stability, growth and employment was not met.

the introduction of common policies.[23] In a sense this aspect of enlargement theory began to merge with more general integration theory.

7. Conclusions

The aim here has been to identify the main elements of economic theory used to analyse the long process that led to the 2004 and 2007 enlargements of the EU. From early concerns with the level and structure of trade of the future member states, analysis moved on to other aspects of extending the single market, such as labour and capital movement, and of incorporating these countries in economic and monetary union. In this the evolution of the theory has tracked the well-known 'stages' of integration first indicated by Balassa (1961). Though there were various studies of the costs and benefits of enlargement, there were few attempts to evolve these into an overall application of the economic theory of clubs, probably reflecting the limitations of the approach.

As emerges from the discussion here, 'enlargement theory' is eclectic and it is difficult to define its boundaries. There is frequent overlap with more general integration theory so at times it is difficult to distinguish the two. Moreover there seems little connection between the theoretical literature and the Copenhagen criteria, which allegedly were designed to select which countries were ready and able to join the EU. While the political accession criteria played some role in the selection process, this was not really the case for the economic criteria. The bottom line is that choice of who joins the EU and when is essentially a political issue, and the practical impact of the Copenhagen economic criteria is extremely limited.

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[23] In particular, the business cycle in Cyprus, the Czech Republic, Malta, Poland and Slovenia was found to display a high degree of alignment with the EU(15). This was said to have the advantage of favouring lower volatility and country-specific shocks thereby facilitating the introduction of common policies. Fidrmuc and Korhonen (2006) present an overview of 35 studies of business cycle synchronisation and asymmetric shocks and find most synchronisation with the euro area for Hungary, Slovenia and Poland. The lower synchronisation found for Hungary in European Commission (2009) is perhaps to be explained by fiscal slippages in recent years. Other studies relying on cross-country correlations of output fluctuations include those of Darvas and Szapáry (2008), Eickmeier and Breitung (2006), Afonso and Furceri (2009), and Artis, Marcellino and Proietti (2004).

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