The impact of EU Enlargement on External Relations, notably with the US and Russia

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This presentation examines the external effects of enlarging the European Union (EU). Unthinkable not so long ago, EU enlargement is now imminent. At the conclusion of the Laeken Council of 14 - 15 December 2001, the EU Member States declared that “the EU is determined to bring the accession negotiations with the candidate countries that are ready to a successful conclusion by the end of 2002, so that those countries can take part in the European Parliament elections in 2004 as members”. It estimates that “if the present rate of progress of the negotiations and reforms in the candidate States is maintained, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic, the Czech Republic and Slovenia could be ready.” It added that Romania and Bulgaria have made significant progress to become ready for Membership. At the beginning of 2002 the Commission will propose common positions on the agriculture, regional policy and budgetary chapters on the basis of the present acquis and of the principles decided on in Berlin. Proceedings on the drafting of the accession treaties will begin in the first half of 2002.

Here, however, I will focus not so much on the actual process of EU enlargement but on the profound economic and political effects of enlargement on relations with third countries, notably US and Russia. I will not deal much with security issues, as these are more in the realm of NATO relations (although these are, of course, linked to what I will discuss, which are some of the economic and political economy effects).

In the course of my work as a Commission economist dealing with enlargement issues, I have come to realise the enormity of EU Enlargement issues. Most obviously, enlargement represents a multi-dimensional economic, political and social transformation for the Candidate Countries themselves. At the same time, it affects existing EU Members and third countries. The 1st century Roman historian Tacitus stated that ‘All great things are full of ambiguity’. EU enlargement is certainly a great thing! An unprecedented number of countries have applied to enter the Union, which will challenge both these nations and the existing structure of the Union itself. Accession therefore brings concurrent pressures for economic and political reform for both existing and new MS. Inevitably, this will have repercussions for the Union’s external relations.
The dichotomy between ‘external and internal’ is of little analytical use in our increasingly globalised and interdependent world. A large part of the EU economy is effectively outside of the EU, and vice-versa. It is clear that instability around the EU and from further afield can and will directly affect the EU Member States. The interdependence of the global economy is unprecedented in terms of its overall depth and complexity.

Accordingly, an understanding of the effects of EU Enlargement on external relations requires first an understanding of the effects of enlargement on the EU and its new future Members. Through its effects on the Union, enlargement inevitably changes relations with third parties. The economics and politics of enlargement are complex, with the shifting perceptions of ‘us’ and ‘them’ constantly changing priorities and relations with third parties. The economist’s concept of a general equilibrium, or continuous dis-equilibrium, is perhaps a useful notion here.

These third parties also influence the European Union. The idea of the completion of the Internal Market, proposed in 1986 as the ‘Single Market’ or ‘1992’ project, was mostly a product of the perception that Europe was falling behind the US and Japan in economic terms. The architects reasoned that the fragmented markets organised along national boundaries within the European Community were hindering Europe’s economic performance. Similar reasoning lay behind European Monetary Union (EMU) and the recent introduction of the Euro. More broadly, there is an argument that the very creation of the Community and its subsequent rounds of Enlargement were reactions to the danger of instability and increasing divergences along EU borders. The consequently high costs of not accepting the Candidate Countries as Member States constituted a powerful argument for acting quickly to diffuse those pressures by internalising them. I note in passing that this logic of security and stability was also how the Roman Empire started.

My focus here is quite specifically on some of the effects of EU Enlargement on relations with the US and Russia. It is well to note, however, that relations with all neighbouring countries in the Mediterranean, and with the less developed countries of Asia and Latin America are under
review and also in a state of flux. Further, changing EU relations with Russia might affect relations with the Middle East in an area like energy dependency.

It is also clear that enlargement will not affect economic and political relationships to the same degree, nor necessarily in the same direction. This is very much where the importance of empirical work comes in, and I freely admit that this I have not done.

Let me first make a few comments on EU Enlargement itself. This is historically the most challenging and difficult of the Union’s enlargements. But the potential rewards are commensurate. Enlargement, the widening of the EU, is one dimension of integration. The other dimension is deepening the Union through its economic cornerstone, the Single Market. One way of looking at integration is as an ongoing process with no obvious ending point. Accordingly, its effect will be to elevate the importance of cross-border issues to third parties such as trade in services, foreign investment, public health, the environment and crime.

What is the incentive for a European country want to join the EU in the first place? One can, I think, group these under three headings: historical, economic, and political: Very briefly:

**Historical** – There are the old ideas of Christian and Roman Empire myths of unity; there are commonalities in geography, culture and language; there is the experience of 20th century wars; the need to defend against domination by Germany, the US and the USSR; and after its constant feuding, there is a belief that the credibility of the nation state itself can only be reinstated through surrendering some sovereignty.

**Economic** – Most obviously, there is the lure of access to one of the largest and most sophisticated markets; the stimulation of competition; the creation of economies of scope and scale; the redistribution of financial resources; the economic interdependence that creates economic incentives to co-operate; and the fact that in a globalised economy, capital tends to undermine *de facto* national sovereignty toward larger groups of countries.
Political – The ‘elephant’ argument - the Union already affects the margin to manoeuvre, so why not join and be included in its benefits; the Union is a way of ‘locking in’ other nations into binding commitments (and your own future governments); it offers power for a nation’s elites and a stronger voice both in Europe and vis-à-vis third countries; it offers security, both from each other and from Russia; and there is the symbolism of belonging to Europe.

In short, EU membership is a huge confidence-building measure. It confers credibility on the Member country through the acceptance of clear and enforceable mutual restraint. It is therefore a public good for economic actors and investors. Membership decreases uncertainty in wide areas of public life since Membership rules - the *acquis communautaire* or body of EU law - are clear, well established, have legitimacy, and are institutionally enforced.

The international affirmation of the EU project has also been expressed in tangible commercial terms. For instance, the announcement of the 1992 project with the introduction of the SEA in 1986 produced a surge in foreign and domestic investment in the EU. Similarly, there has been a wave of mergers and acquisitions in the EU in the lead-up to the introduction of the Euro, and a surge in foreign direct investment toward the confirmed candidate countries.
On the edge of internal and external relations:

Who can become EU Member?

Article O of the 1992 Maastricht Treaty (modified in the 1997 Amsterdam Treaty) states that “Any European state which respects principles of liberty, democracy, human rights and fundamental freedoms and the rule of law may apply to become a member of the Union”. ‘European’ is not defined! In those cases where it is not clear whether a country is European or not, the decision is ultimately political, not geographic.

In historic terms, Candidate Countries were always very much part of Europe. Trade and population and cultural links with Western Europe were all very close, especially with strong Germanic influences throughout ‘Mitteleuropa’. Yet the idea of a ‘gap’ is quite persistent, and the idea of an East-West divide has been with us for the last 1800 years, linked to the divide between West Roman and East Roman or Byzantine Empire, later followed by the Ottoman divide that ran through Europe. In that sense the divide in the 2nd half of the 20th century was nothing new.

Each enlargement so far has increased the diversity of the EU in terms of economic structures, regional development and culture, and put strain on existing decision-making structures and appeals to social solidarity. The upcoming round will continue this pattern. The problem of progressively enlarging the EU is how to ensure the unity of the whole while respecting the diversity of its parts. This is the paradox of European enlargement.

The Commission has always argued that in order to deal with increased diversity, it would need competence in increasingly wide areas of the public arena. At the same time, there has always been a real fear among existing MS that enlargement could undermine the *acquis communitaire* which had been accomplished with often difficult compromises. For this reason, each widening of the EU (enlargement) has usually been accompanied by deepening (integration).

It is no surprise, then, that the largest round of enlargement to date was accompanied by the most adventurous exercise in integration - EMU. Both are high-risk projects, where failure in
either could lead to breakdown or severe undermining of the EU. I would argue that that knowledge is precisely what makes them credible.
Effects of Enlargement on External relations.

1- General: Economic & political:

The effects of enlargement on EU growth:

Demand and supply effects: EU enlargement with all the current candidate countries will add some 100 million people to the EU, which is around 30% of the current EU-15 population (including Turkey brings the total increase to 170 million). It will imply the incorporation of economies with different levels of development and different economic structures.

Overall, total GDP of all current Candidate Countries is small in comparison to the EU (about 5% of EU-15 GDP, or 10% in Purchasing Power Parities of PPP. This is comparable to the effect of including Greece, Portugal & Spain in 1981). Income disparities in the EU will increase as a result of the integration of economies with much lower income levels than the EU average (currently at about 40% in PPP terms). Equally, the average GDP per capita in the EU will fall, which could have large implications for structural fund flows.

According to a recent Commission study, enlargement could increase the GDP of new MS by between 1.3 - 2% a year for the next 10 years. The extra stimulation of a catching-up process that candidate countries are expected to experience after accession will progressively increase their share in EU GDP. However, this process may take a generation or so. Given the small size of the joining economies, the growth effect for the existing EU MS is expected to only be of marginal impact, with Germany and Austria the greatest beneficiaries. Overall, the positive impact on EU growth would be modest in the short/medium run at cumulatively 0.7% EU GDP. It is also important to note that no existing MS will suffer. Hence, the net demand growth effect of enlargement on total EU trade vis-à-vis the rest of the world in the short-run is expected to be marginal as well.

In the medium-to-long term, however, growth and trade effects could be more significant than this. This is not only due to higher growth and demand in the new MS, but also to stronger supply side effects, with restructuring of industries in both new and existing MS. The extension of the Single Market to candidate countries will foster greater competition, increased investment and economies of scale for the new and the existing MS. The increase in divergence in the EU with the accession of new MS can be used here as a source of supply restructuring for competitive advantage.

This restructuring has already been happening, intensely in the Candidate Countries and to some extent in the existing MS industries. Production structures in a number of sectors of the candidate countries are largely complementary to those in EU economies. A number of EU industries in existing MS (notably EU ‘border’ states Germany, Austrian, Italy, Scandinavian MS) had already started restructuring before any formal accession procedures had begun with the Candidate Countries. These restructuring pressures and possibilities for EU industries were certainly pushed further by the outlook of accession. Industries such as cars, machinery, textiles, consumer electronics and food processing have been working to create international production networks (IPNs) through trade and investment in mostly low/medium value added products in the Candidate Countries.

This is also apparent in the trade data. There has been a massive reorientation of Central and Eastern European Countries’ (CEEC) trade with the EU MS in the last decade or so, gaining a 60-70% trade share for most candidate countries. These levels were last seen in the 1920s and 1930s. In the same period, the share of these countries in total external EU trade has gone up from around 4% to 12%. This has not been a simple redirection of trade; it has been estimated that at most 20 per cent of exports is ‘diverted’ Comecon goods. Export growth is either in products that were not exported at all to former Comecon markets, or in ‘traditional’ export items that have been upgraded.

At the same time the nature of EU-CC trade has clearly been changing from inter-industry toward intra-industry and intra-firm trade in the last decade. This is one hallmark of economic
integration and IPNs. The processes will only speed up through the increased certainty and pressure of approaching Membership.

These trade developments are likely to impact on extra-EU trade flows with other EU trade partners producing competing products in South East Asia, the Mediterranean and Latin America. In a situation of direct competition among similar products on EU markets, the new MS might then have the ‘home’ advantage, with geographical closeness and as part of the EU. At the same time, overall competitiveness of EU industries could increase as result of industrial restructuring. This would then impact on trade and investment flows with the US, Japan and other OECD trade partners.

The prospects of enlargement in turn can provide an incentive for other countries to create alliances and/or expand trade and seek market access, with each other and/or with the EU. For instance, slower economic growth in the US can further lead to other countries seeking closer links toward EU (eg. Mexico).

The other effect to note is that enlargement will make the EU zone as a whole relatively more closed in trade with the rest of the world. About 55% of EU trade is already intra-EU trade, and this percentage will increase with enlargement. However, I think this is primarily a purely statistical nomenclature effect. It does not represent a weakening of trade and investment interdependency of the EU or a closing of EU borders with the rest of the world. Essentially this same point was also valid for previous enlargements, and was made during debate on the Single Market to address ‘Fortress Europe’ fears.

Much of above can be put in economists’ terms of trade creation/trade diversion, and similarly for FDI and other capital flows. Theoretically and a priori, it is not clear which effect will dominate and therefore it is possible that other trade partners will suffer from trade and investment diversion toward an enlarged EU. I note however that the historical evidence solidly and clearly points to trade and investment creation rather than diversion, with growth effects outweighing static trade diversion effects.
Enlargement will increase the weight, power and prestige of the EU in international affairs. The EU(15) is already economically large with a 32% share in world GDP, and represents the largest trading group with about 25% share in world trade (excluding intra-EU trade). In the short run, however, the main effects of enlargement will be on population and the number of MS it represents, rather than its economic weight. Therefore, the short run effect will mostly be felt through the outcomes of trade negotiations and on obtained terms of trade and market access. In the longer run, the EU’s economic clout will build through higher growth, demand and supply effects.

Even with the positive economic supply and demand effects for the existing MS and much more for the new MS, it is fair to say that the main advantages of Enlargement for the EU will not be so much economic but in creating an expanding zone of stability and security in Europe. Given European history, it is hard to overstate the benefits of such a project, both within Europe, for surrounding areas, and by implication for the rest of the world.

At the same time, increased Membership and diversity makes it more difficult to speak with one voice. However, political convergence through integration diminishes economic divergence. On this understanding, it should become easier to use Europe’s ‘one voice’. One can even argue that it is deepening rather than widening the Union that will have most effect on the EU’s role. Widening increases its sheer political clout, but deepening allows it to develop a common voice.

Deepening takes place, for instance, through the reinforcement of the Single Market through EMU and the Euro. It is clear that this deepening will have effects on external relations as well. This issue merits a separate presentation. Here, I will only note that, like enlargement, EMU is expected to increase growth in the Union through lower interest rates, increased transparency and business confidence and macro economic stability through lower inflationary pressure and the Stability Pact. There will be similar positive effects on overall trade demand.

The enlargement process does hold its traps, however.
New MS bring in their own network of contacts and preferences into EU. With each enlargement, new Membership also changes the direction and preferences for future enlargements. For instance, the recent EFTA enlargement added to the inclination to improve transparency and tightening application of Single Market rules. The new MS had strong preferences in favour of high social and environmental standards. The effect of enlargement from 12 to 15 MS has undoubtedly been to raise these standards.

The next round of enlargement will again change balances in different domains. Candidate Countries could be committed Europeans who want to strengthen their position at the periphery of Europe. They have strong historic incentives to do so. On the other hand, surrendering sovereignty might run counter to their ideas on their newly won independence. They consider themselves as small countries vulnerable to external dominance and are therefore more likely to fear outside incursion. Their history of unconstrained domination by larger states only adds to these fears. But at the same time, Candidate Countries are eager to join the EU to confirm their European and national identity. It is clear how that would translate in voting in the Council. Nevertheless, I would expect that new MS would bring pressure for further enlargement (Poland for Ukraine, Romania for Moldavia, Slovenia/ Hungary/ Bulgaria/ Romania for other ex-Yugoslavia states and Albania), would work more closely on relations with Russia, and would attach less weight to development aid and less developed countries.

EU enlargement enhances security by lessening ‘grey’ areas in Europe and promoting stability and economic growth, with positive effects on neighbours. However, in establishing new relations with these EU neighbours, it is important that the EU avoids a sense of creating new dividing lines in Europe, either between new and old MS or an enlarged EU and the immediate neighbourhood.

Russia

As candidate countries rapidly advance toward membership and the Laeken Council of December 2001 set firmer dates for such new Membership, there is a renewed sense of urgency
on EU-Russia relations. Of course, Russia has a big presence in Europe, both historically and politically. Its attitude directly affects the whole European and Central Asian regions, not so much in economic but political and security domains. It is not hard, therefore, to predict that EU enlargement will lead to deeper and more complex economic and political relations with Russia.2

Economically, Russia has a GDP less than that of Spain. Trade flows between the EU and Russia are relatively small at about 4% of extra-EU trade (the EU takes 40% of Russia’s trade). This low overall percentage perhaps does mask the importance of certain sectors, notably energy. The 1998 economic crisis in Russia hit the EU mainly through confidence effects rather than any direct trade, investment or financial channels. Russia needs EU capital and trade to help its process of economic reform. Its welcoming the upcoming enlargement reflects a belief that an enlarged zone of prosperity and stability in Central Europe and enlargement–induced growth in the EU is strongly in its interests.

With enlargement, direct trade links between CEECs and Russia will be internalised. Although Russia is not the major trade partner of the Candidate Countries (as in the Comecon days) both sides have the experience and interest in opening their trade links. Moreover, the Candidate Countries have a high level of energy dependence on Russia. An enlarged EU will be more dependent on imported Russian energy supplies. Oil and gas currently already account for over half of Russia’s exports to the current EU. The EU’s increasing energy dependency on the one hand, and Russia’s crumbling energy infrastructure on the other, indicates a future of strong mutual interdependency.

Russia already neighbours the EU through Finland, and after enlargement the EU border will extend to the Baltics and Poland by proxy of Byelorussia. However, the direct threats or problems posed by Russia to European security are no longer of a military nature. More urgent is the progressive breakdown of civil society, declining life expectancy, the health crisis, large

2 The EU has created various economic and political co-operation agreements with Russia, such as the 1997 Partnership and Co-operation Agreement, 1999 Common Strategy Paper.
scale environmental pollution and widespread crime and corruption. Enlargement brings the EU closer to this, literally.

Clearly, these problems will affect the EU more directly than the US. The EU has an obvious long-term interest in a stable & prosperous Russia. The attitude of EU politicians toward Russia will be crucial here. To what extent will Russia be given a voice as a partner of the EU with legitimate concerns on how enlargement impacts on the Union? To what extent will Russia be allowed to interfere in internal EU policy and enlargement?

New MS will have significant influence on EU relations with Russia. All applicant countries attach major importance to relations with Russia and the Ukraine. Upon entry, the new MS take with them intimate knowledge and various close historic and economic relationships with Russia. No doubt there is a certain fear of or weariness toward Russia. But one of the benefits of EU membership is that new States can deal with Russia with the imprimatur of the EU. However, until they are actually members, there are also worries that Russia might try to influence membership proceedings which may lead to more delays. As indicated earlier, new MS might push for membership of neighbouring countries. It is not clear if the Ukraine, Belarus, Moldova and other NIS will apply for Membership. Nor is it clear what Russia’s react would be, or if indeed it would itself apply for Membership. For the moment, though, these are not pressing issues.

One potentially major problem in EU-Russia relations is the geographic situation. After enlargement, part of Russia will be encircled by the EU with the Russian oblast of Kaliningrad (or formerly Koenigsberg in Prussia). This region, wedged on the Baltic coast between Poland and Lithuania, has a population of 1 million and supports a naval base. Is it a Trojan horse with smuggling, high crime and disease levels and environmental disasters (and reports of nuclear weapons stationed there), or a bridge for closer economic relations?

It is clear that Russia hopes to use Kaliningrad as a lever to influence outcomes in EU enlargement. The EU is very concerned about the situation, and needs to take into account the interests of EU and new MS. At the same time it wants to keep Russia happy while resisting
its pressure to use this issue to influence or delay the enlargement process. The latter especially is cause for concern for Poland, Lithuania and Latvia. The European Commission has launched a discussion and published a Communication on the EU and Kaliningrad.\(^3\)

Germany still remains a key player in the dialogue with Russia, as it has been throughout the EU’s existence. Enlargement will be more likely to enhance than diminish this. Germany has pursued its own agenda for enlargement, viewing it as the most important part of its European policy. It has always had strong links and influence in Central Europe. Its trade with CEECs has been a dominant part of those nations’ earnings. Germany also has to show its European credentials to gain the support of new MS, especially Poland. In effect, Germany will be major beneficiary of enlargement. It already seems to be moving toward a firmer political voice in the EU, and this renewed confidence could well provide a shift in its usually cautious stance with Russia.

**Transatlantic relations EU-US**

From the outset, the US has been a firm and unwavering supporter of European integration and enlargement. I would therefore expect that security and economic issues will remain the driving force in EU-US relations. However, economically and politically the picture does become more complex with Enlargement:

**Economic:**
The US and the EU have been each other’s major trade and investment partner for the last 40 years. At the same time, the US always has had fairly close trade and investment relations with the Candidate Countries. Next to the EU, it has often been the major investor in Candidate Countries. Enlargement will therefore strengthen the relationship with the US as these Candidate Countries gain admittance. The growth argument applies here as well. Relations could become closer still as Membership increases economic growth and economic opportunities for US enterprises and investors in an enlarged EU market. On the other hand, enlargement and economic restructuring in the EU integration process might also act as a

stimulus to the competitiveness of the EU-US relationship. To the extent that US firms might suffer, trade frictions may increase. This would be exacerbated by America’s dealings with a larger EU at trade negotiations.

**Political:**
There often seems a contradiction in the US attitude toward the EU. One the one hand, it wants an economically strong Europe to take its (financial) responsibility in the world economic order, and has unwaveringly supported the creation of the EC and further EU enlargements. On the other, it often wants the EU to be a junior partner, if not in economic then in political and security issues. Further enlargement will only bring this dilemma to the fore. Naturally, the new EU MS consider good relations with the United States as indispensable both for economic reasons and security reasons. This pro-Atlantic attitude will also translate in Council voting and in the relations of an enlarged EU with US. Poland in particular seems strongly supportive of the US.

A similar factor plays on American public opinion. Large ethnic lobbies in the US – notably the Polish community - could play a positive role in pushing toward co-operative US relations with the enlarged EU. At same time, the US will need to shift its relations with the EU, the Candidate Countries and Russia. It will have to deal with the Candidate Countries as part of the EU, thereby giving less automatic weight to Russia as the only major political partner in the region’s foreign policy. Given Russia’s strong economic interest in an enlarged EU, US support for enlarging its economic and political ties with the EU may proceed at Russia’s expense.

With enlargement, the US will expect the EU to take greater responsibility for its own security, as military Cold War pressures decrease, enlargement takes in former the Warsaw Pact members, and the fight against terrorism intensifies. It will want a stronger EU in international security issues. But again, a more assertive EU could cause greater friction, particularly given the Russia’s diminished military presence.
The change of Presidency in the US seems to have changed American-Russian relations. At first, the current administration did not seem as close to Russia as the Clinton administration, and my estimation was that this might be incentive for Russia to forge closer relations with the EU. However, this depends on the effect of Russia’s revived security relationship with the US after September 11.
Conclusion

In summary, enlargement will prove a positive for bilateral relations between the US and the EU but will also make them more complicated. The US supports enlargement as next big step toward European integration and securing the gains of the post Cold War. There are also considerable economic opportunities. On the other hand, the possibility of a larger, more competitive and more assertive EU may threaten US interests. Deepening EU relations with Russia will herald an opportunity for the US to secure a more prosperous, stable Russia. Russia appears to consider enlargement an opportunity to drive a wedge between the EU and the US. All the more reason, then, for collaboration between the European Union and America to avert this possibility.