

## **SCOTTISH EXECUTIVE ECONOMIST GROUP**

### **DISCUSSION PAPER SERIES**

#### **PREFACE BY DR ANDREW GOUDIE, CHIEF ECONOMIC ADVISER**

This is the second paper in the new *Discussion Paper* series introduced, via the Internet, by the Scottish Executive Economist Group in September 2001.

With the establishment of the new Scottish Parliament, there has been a reassessment of the way in which the economics knowledge and thinking of the Executive are presented to the external community. This has been driven by the desire to stimulate a more active discussion of the range of issues surrounding economic development and the wish better to inform that debate.

Two new regular publications on the Scottish economy have already been introduced:

- ◆ ***Scottish Economic Report***: this has been published twice-yearly, since January 2000. It incorporates a review of the progress and prospects for the Scottish economy, together with reviews of the broader global, European and UK economic contexts in which the Scottish economy is set. It also includes a selection of short articles on key topical issues or recent work of Executive economists;
- ◆ ***Scottish Economic Statistics***: this is published annually, with two editions to date in February 2000 and March 2001. It draws together the full range of economic statistics for Scotland, and includes a selection of articles on key developments in economic statistics or methodology issues.

***The Discussion Paper Series***: A third strand to the dissemination of the economic thinking of the Executive has also now been introduced. The *Discussion Paper Series* is being made available via the Internet in order to meet the likely preference of the anticipated audience for this work. It is hoped that this will allow for more speedy publication of work as it becomes available, as it will avoid the time-consuming aspects of the traditional publication route. Feedback will, of course, be welcome on this aspect of the new series.

The *Discussion Paper* series is intended to provide a forum for articles which are longer, more detailed and possibly more technical than the short articles which appear in the SER. It is aimed at those with a specialist interest, and therefore may be technical or contain some specialist jargon, as necessary. Generally, they will be directly relevant to key policy debates that are of current concern to the Executive but are not intended to express a Scottish Executive policy position. Some may, however, not be of immediate topical interest or relate directly to the current policy debate, but will nevertheless contribute to the enhancement of our knowledge of Scottish economic development.

The second paper in this new series is 'Benefits and Threats of EU Enlargement for Scotland', by Dr Fabian Zuleeg of the Monitoring, Evaluation and Economic Analysis Unit in the Scottish Executive Education Department. This paper sets out Scotland's position in relation to enlargement. The article discusses benefits and threats from enlargement, including trade, investment and linkages. The article notes that the current debate in Scotland seems to focus on the threats arising from enlargement, rather than debating how Scotland can benefit from the opportunities. The threats are examined and it is argued that the threats are limited. The article notes that, in any case, UK and Scottish policy is supportive of enlargement and that it will take place in the near future. Benefiting from the opportunities requires more engagement with and information regarding the enlargement process. The article concludes that Scotland needs to use its linkages to encourage businesses to benefit from enlargement.

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# **Benefits and threats of EU enlargement for Scotland**

## **Discussion Paper<sup>1</sup>**

By

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<sup>1</sup>This discussion paper considers the effect of EU enlargement on Scotland. It does not express an official policy position of the Scottish Executive and should be quoted accordingly.

## EXECUTIVE SUMMARY

- This discussion paper has been written to contribute to the discussions in Scotland about the potential economic impacts of enlargement of the European Union. It is not intended to express a Scottish Executive or UK government policy position and should be quoted accordingly.
- The EU is set to grow to about 500 million consumers with the accession of 10 countries from Central and Eastern Europe (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia), as well as Cyprus and Malta. In addition, Turkey has also applied to join the European Union.
- Enlargement provides an historic chance to overcome the divide in Europe permanently and also offers rich potential for increasingly beneficial trade and exchange with the transition economies. Given the need to ensure that the requirements of the *acquis* are properly addressed in the enlargement negotiations, it is not expected that all applicant countries will join together. Current indications are that 10 countries (8 from Central and Eastern Europe as well as Malta and Cyprus) will join by 2004, with Bulgaria and Romania needing more progress. For some of the applicants, uncertainty concerning the accession process itself could become increasingly difficult to manage in terms of political and economic costs.
- The CEECs can only become a member if they meet the following conditions:
  - Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
  - The existence of a functioning market economy, as well as the ability to cope with competitive pressures and market forces within the Union;
  - The ability to take on the obligations of membership, including adherence to the aims of political, monetary and economic union.
- The formerly planned economies of Central and Eastern Europe have a much lower standard of living than the present member states and their accession will require a fundamental reform of the regional policy of the European Union. The applicant countries also have a much higher dependence on agriculture, which will affect the EU's Common Agricultural Policy (CAP).
- The impact of enlargement is difficult to estimate, especially since the distribution of effects between the current members and the accession countries and the distribution within these groups is likely to be uneven. The biggest impact is likely to be on the accession countries, which will have important knock-on effects on current members. For example, in case living standards do not improve in the accession countries, large scale migration to the West could become a distinct problem.

- The interdependence of Scotland with the rest of the UK and the wider EU will entail that the effects of enlargement on the UK as a whole are also felt within Scotland. Enlargement can have beneficial impact in a number of ways:
  - It creates the historic chance to create prosperous and stable democracies, which can take full part in the European political and economic processes.
  - Benefits from trade and investment, as well as increased wealth and competitiveness in the candidate countries, will create a more competitive and diverse Single Market in the EU, benefiting the consumer.
  - Enlargement would enable the EU to play an even more prominent role in global economic developments and increase international competitiveness of EU firms.
  
- The EU has a crucial role to play to create a ‘level playing field’, which enables all European countries to trade and invest freely without any one country distorting competition. For Scotland, the current trade situation still falls short of long term expectations. The main export markets for Scotland in CEE are Poland, Hungary and the Czech Republic but the share of exports to the CEECs has been small. The UK is also not one of the major investors in the region.
  
- Increasing trade with Central and Eastern Europe also carries competitive threats for UK, and Scottish, firms. Scotland has competitive advantages in areas such as technology, infrastructure, the commercialisation of university work and a highly skilled, trained and productive workforce, but it might have disadvantages due to high labour costs, lagging productivity compared to other global competitors, location and taxation. One of the fears that has been expressed is that Scotland will lose out in the competition for foreign direct investment (FDI), but in the longer term, the competitive pressures from the CEECs will lead to improved productivity and competitiveness in Scottish firms through, for example, more efficient supply chains.
  
- Scotland has a number of important linkages with the Countries of Central and Eastern Europe, for example Scotland’s involvement with the Czech Republic as part of the Twinning initiative of the European Union, which means that Scotland can have an important influence on the development of European regional policy.
  
- For Scotland the overall impact is also likely to be positive, in line with the impact in the rest of the UK. There are particular opportunities for Scotland arising from the enlargement process:
  - Enlargement offers a rich potential to increase trade and investment. The realisation of these benefits will in part depend on information available and public policy has a role to play in this area.
  - The threats from enlargement to the Scottish economy are likely to be relatively low, due to structural differences between Scotland and the CEECs.
  - The developing linkages with Central and Eastern Europe can provide the basis to facilitate beneficial exchange.

## **1) Introduction**

1. This discussion paper has been written to contribute to the discussions in Scotland about the potential economic impacts of enlargement of the European Union. The points raised in this paper are intended to contribute to an open and comprehensive discussion. They are not intended to express a Scottish Executive or UK government policy position and should be quoted accordingly. This paper sets out the current research on the economic impact of enlargement on Scotland, as well as some of the key influences, which are determining the Scottish policy position. The paper will make frequent reference to the Scottish position from already published material but the conclusions drawn are those of the author. The author is happy to receive comments on the content of this paper and the Executive will continue to monitor European developments to decide whether additional economic analysis in this field is required in future.
2. Scotland has the opportunity to benefit further from European integration and enlargement, while needing to address any threats to the Scottish economy. It has a strong position to benefit from European developments as a strong region in a strong member state. The developing Scottish position should be seen as an integral part of, and a complement to, the developing UK position. It is necessary to engage in the discussions taking place at the European level to ensure that Scottish concerns and positive policy impulses are taken into account and to determine the best policy responses.
3. This paper does not address in detail the EU budgetary implications associated with enlargement. In part, this reflects the need to emphasise other aspects of enlargement, which have not yet been debated in great detail. It also reflects the uncertainty associated with these costs, as the EU is reforming to adapt to the challenges. More importantly, however, enlargement will take place in some form regardless of Scotland's position. To benefit from the large potential for Scotland in the longer term policies need to be adapted as quickly as possible to changing trade and investment flows in Europe.

## **2) The EU enlargement process**

4. The EU, the biggest single market in the world, is set to grow even further to about 500 million consumers with the accession of at least 12 countries, most of them from Central and Eastern Europe. The countries in the accession process are 10 countries from Central and Eastern Europe (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia), as well as Cyprus and Malta. In addition, Turkey has also applied to join the European Union<sup>2</sup>.
5. Enlargement should be beneficial for both Central and Eastern European applicants and the current EU member states: "On balance, enlargement should be economically

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<sup>2</sup> This paper mainly focuses on the Central and Eastern European applicants.

beneficial for the Union because it is likely to lead to better performances (economies of scale, higher growth and investment, more technological innovation, stronger global corporate players) than those achieved at present by the existing EU and applicant states. From an EU-wide perspective, the greater heterogeneity in production cost within the Union could become a source of competitive advantage. There is, however, a risk that unadjusted adjustment strains could weaken the overall economic situation of the EU.”<sup>3</sup>

6. The formerly planned economies of Central and Eastern Europe have a much lower standard of living than the present member states and their accession will require a fundamental reform of the regional policy of the European Union. The 2<sup>nd</sup> Cohesion Report notes that enlargement will “pose a challenge to cohesion in two ways. First, it will more than double the population living in regions with GDP per head of less than 75% of the present EU average - EUR 20,213 per head - from 71 million to 174 million ... Secondly, it will increase the intensity, or scale of the disparity.”<sup>4</sup>
7. Scotland, in line with the UK, supports this historic process of accession. Not only does accession provide an historic chance to overcome the divide in Europe permanently, it also offers rich potential for increasingly beneficial trade and exchange with the transition economies. Given the need to ensure that the requirements of the *acquis* are properly addressed in the enlargement negotiations, it is not expected that all applicant countries will join together and the earliest accessions are expected to be in 2004. Due to the large difference in standards of living, it is clear that even accession of the frontrunners of the accession process (such as Hungary and Slovenia) will entail a large transfer of existing funds from current member states to the accession countries, which will have an effect on Scotland’s relationship with the European Union. However, devolution has enabled Scotland to respond to the challenges inherent in this changing relationship with policy developed specifically for Scottish needs.
8. One of the effects of the process of enlargement has been the reform process taking place within the EU. The EU is aware that reform is an essential component of enlargement. The Representation of the European Commission notes that “The accession of these [CEE] countries will have profound effects on the shape and structure of the EU, requiring the evolution of new working arrangements to ensure that the institutions remain manageable. The need to decentralise administration to the lowest level should be to Scotland’s benefit.”<sup>5</sup> The EU has already instigated a comprehensive reform programme. Agenda 2000 has started the process of reforming the EU’s expenditure, including the Common Agricultural Policy (CAP) and the European Structural Funds (ESF). The necessary institutional reform is part of the

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<sup>3</sup> Avery, G. & Cameron, F. “The Enlargement of the European Union”, 1998, p. 141.

<sup>4</sup> 2<sup>nd</sup> Cohesion Report, p. 8.

<sup>5</sup> The European Commission Representation in the United Kingdom, “Scotland – Scotland in Europe”. The text can be found at <http://www.adapt.ecotec.co.uk/regions/scotland/contents.htm>

Treaty of Nice, which addresses the reform of the Commission and the Council of Ministers.

9. Initially, the EU created some limited aid programs, like the PHARE program, and otherwise focused its attention on the area of trade. Here, the so-called Europe Agreements were negotiated in 1991 with most of the countries of Eastern Europe. The Europe Agreements liberalised trade in all but a few sensitive sectors such as agriculture and steel. The restrictions focus on so-called 'sensitive products', which reflect the fear of Western Europe of being swamped with cheap wage goods, produced with low environmental standards and distorted input prices. But they might also reflect producers' interests in some sectors. There is also some scope for 'managed trade', i.e. trade restrictions, in other areas concerning competition and stability considerations. This has not stopped trade increasing quite dramatically and the restrictions might well lead to new sectors of comparative advantage emerging.
10. The EU committed itself early to the eventual membership of the Eastern European countries. But the Central and Eastern European Countries (CEECs) have been facing a momentous challenge. Not only have the radical changes to their economic and political system over the last 10 years created a number of problems, but they have also been preparing for accession to the European Union. To become a member state of the EU is a difficult process in its normal due course, but these countries also face tougher entrance criteria than any accession countries before them. In particular the Copenhagen European Council of June 1993 states that any of the CEECs could become a member only: "if they meet the following conditions:
  - Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
  - The existence of a functioning market economy, as well as the ability to cope with competitive pressures and market forces within the Union;
  - The ability to take on the obligations of membership, including adherence to the aims of political, monetary and economic union" (Agenda 2000, Summary and Conclusions).
11. These conditions are not easy to fulfil and those countries, which started accession talks in the first wave<sup>6</sup>, are not expected to join before 2004. Accession is by no means automatic – rather, the contrary applies. The CEECs are expected to prepare themselves in a number of ways for accession. They are expected to fulfil the accession conditions almost completely. Most notably, they are expected to transpose most<sup>7</sup> of the *acquis communautaire*, the body of law defining the EU, before accession, which also implies having the necessary institutions as defined by the EU.

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<sup>6</sup> Those countries accepted for accession talks in 1998 are the Czech Republic, Estonia, Hungary, Poland and Slovenia, while Slovakia was rejected due to political criteria and Bulgaria, Latvia, Lithuania and Romania were rejected due to the economic criteria. There are indications now that it is likely that all accession countries bar Bulgaria and Romania will join in the first wave.

<sup>7</sup> Some areas of the *acquis* are already seen as virtually impossible to fulfil and thus will probably be excluded. These include, for example, some environmental and energy directives.

This process has often been described by the term ‘moving goalpost’ as the *acquis* is changing over time<sup>8</sup>. A recent example have been anti-terrorist measures in the wake of the 11 September attack, where the EU response will put further obligations on the accession countries in the Justice and Home Affairs field.<sup>9</sup>

12. This extensive list of reforms is reinforced by the EU's resolve to make pre-accession aid and, indeed, accession itself conditional on the fulfilment of an accession timetable of reforms: "From 1998, reinforcement of the pre-accession strategy will be accompanied by a move to make the granting of European Union assistance, particularly financial assistance, to the applicant countries conditional upon their implementing the programmes aimed at preparing them to meet their obligations as future Member States."<sup>10</sup>
13. Some doubts remain whether the costs of reform can be covered even with the most generous outside assistance, especially in those countries furthest behind in the accession process. The adjustments include reforming administrative systems in all applicant countries, heavy investment and restructuring in sectors such as environment, agriculture and transport, the adoption of Single Market legislation, completion of structural adjustment, and the fight against crime, while maintaining human rights. The IMF notes for the environmental *acquis* alone "estimates in several of the more advanced applicants suggest that the annual average cost of complying with the environmental standards for the next 5 years will be around 1.5% of GDP per year." For Hungary, one of the most advanced applicants, the IMF estimates that current EU-related spending amounts to about 2.5% of GDP annually of which only about a quarter is financed through pre-accession aid.<sup>11</sup>

### 3) Scenarios for accession

14. The process of accession might have different outcomes for different accession countries. Given the need to ensure that the requirements of the *acquis* are properly addressed in the enlargement negotiations, it is not expected that all applicant countries will join together and the earliest accessions are expected to be in 2004. This presents certain dangers; the IMF warns "that slow or incomplete accession would weaken the commitment to and momentum of reforms, erode support for accession (among the applicants or current members), and make the transition economies more susceptible to shocks that could move them away from the accession track."<sup>12</sup> However, there are also voices cautioning that accession of countries which are prepared insufficiently might create long term problems. Inotai notes that

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<sup>8</sup> It should also be noted that any form of negotiation involves difficult decisions to be made by applicants and the EU alike. For example, the proposed regime for agriculture was criticised by the applicants at the beginning of 2002 as disadvantaging the accession countries (see for example the Economist, 2.2.2002 and 9.2.2002).

<sup>9</sup> See for example H. Grabbe, "What 11 September means for European enlargement", 2001.

<sup>10</sup> Agenda 2000, Volume II.

<sup>11</sup> IMF "World Economic Outlook 2000", p.p. 163-164.

<sup>12</sup> IMF "World Economic Outlook 2000", p.173.

“Excessive ‘undertaking’ in every field would bring adjustment problems and serial shocks impossible to handle, politically, economically or socially. . . . The outcome would be general instability, along with an economically weakening EU unable to handle widespread crisis in its present form.”<sup>13</sup>

15. For some of the applicants, uncertainty concerning the accession process itself could become increasingly difficult to manage in terms of political and economic costs<sup>14</sup>. As the awareness of the length of the accession process becomes more prevalent, these constraints will be more binding. An empirical study by Bevan and Estrin shows that the position of applicants in the accession process has a direct impact on levels of Foreign Direct Investment (FDI), noting that “the position of the delayed countries could well deteriorate relative to candidates earmarked for early entry, and that the long run dynamic consequences for delayed entrants may be grave.”<sup>15</sup> For these countries, a reassessment of their situation in relation to the EU might be appropriate. The switch to more substantial transfers not linked to accession criteria could be considered for those applicants furthest from accession. Grabbe notes that “It is in the EU’s own interest to provide more assistance to the countries furthest from entry, which are receiving relatively little aid – in comparison with poor EU countries and the front-running applicants – under the current EU budget.”<sup>16</sup> Without a realistic assessment of the current situation, the accession process might be in danger of ending up as a perpetual negotiation for these countries, instead of a stepping stone towards full membership.
16. Estonia, Hungary and Slovenia currently face no major constraints to accession and are likely to be among the first wave of countries to be admitted. The Czech Republic and Poland still have to overcome many constraints, but are likely to be ready in the foreseeable future. A number of countries will find it difficult to meet all of the EU’s criteria, namely Latvia, Lithuania and Slovakia. For others, namely Bulgaria and Romania, the position is even more difficult, with the prospect of membership being doubtful even in the long term<sup>17</sup>. The difficult situation of Bulgaria and Romania is reflected in the 2001 Progress Report by the Commission. The Strategy Paper 2001<sup>18</sup> assessed the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia as functioning market economies, able to compete with competitive pressures and market forces within the Union in the near term. However, Bulgaria

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<sup>13</sup> Inotai, A. “The reasons behind the aggregate ‘Big Bang’ approach to EU enlargement and the dangers it holds”, p. 10.

<sup>14</sup> For a discussion of these issues please see Fabian Zuleeg “Economic and Political Costs of Delayed Accession“, MET Network, 2000. The full text is available from <http://www.man-bus.mmu.ac.uk/bus/activities/papers.htm>

<sup>15</sup> A. Bevan & S. Estrin “The Determinants of Foreign Direct Investment in Transition Economies”, p. 26

<sup>16</sup> H. Grabbe “Profiting from EU Enlargement”, p. 63

<sup>17</sup> The analysis in this paragraph draws on Zuleeg, F. “The Political Economy of the Accession Process: Aspirations of European Union Membership leading to Divergence within Central and Eastern Europe”, PhD Thesis in Economics, Edinburgh University, 2001.

<sup>18</sup> The Commission’s Strategy Paper and Regular Reports 2001 are available from <http://europa.eu.int/comm/enlargement/report2001/index.htm>

was only close to being a functioning market economy and judged to be able to compete in the medium term, while Romania did not meet either criterion despite, for the first time, making decisive progress towards this objective.

17. It is interesting to note in this context, that a frequent argument for membership has been a need to stabilise the political situation in CEE. This argument would suggest that those countries furthest from membership should be given precedence, contrary to their current position in membership negotiations. It should, however, be noted that the decision to admit applicants will also be based on political choices. Recently, the French Foreign Minister suggested that there would be no big difference between accession of 12 countries rather than 10 countries. However, the Commission was quick to point out that only 10 countries had set 2004 as a target date.<sup>19</sup> The Presidency Conclusions of the European Council in Laeken noted that those candidate countries which are ready should successfully conclude negotiations by the end of 2002 to become members in time for the European Parliament elections in 2004. The conclusions note that ten countries<sup>20</sup> are on course, with Romania and Bulgaria needing more progress<sup>21</sup>.
18. The preceding analysis has concentrated on the Central and Eastern European applicants. It has, however, not been applied to the possible accession of Turkey. This is a difficult case, as Turkey in the past has not been sufficiently advanced in terms of democratic stability or respect of human rights to become an immediate contender for membership. However, if Turkey becomes a member in the near future, the economic and political impact of enlargement would be even more significant. Turkey, as a country with about 65 million inhabitants, would be one of the large countries within the European Union and would be entitled to the same representation as France, Italy and the UK. The Turkish economy is trade oriented and low skill, low wage competition could become an important competitive advantage. In addition, migration could also be an important factor. While it is important to keep the case of Turkey in mind, the analysis of trade and investment in the following sections is based on accession of the Central and Eastern European countries. If Turkey would join in the near future, the impact would have to be examined separately to be able to take into account the specific issues associated with Turkey's political and economic status.

#### **4) Current economic position of the applicants**

19. The formerly planned economies of Central and Eastern Europe have a much lower standard of living than the present member states and their accession will require a fundamental reform of the regional policy of the European Union. The applicant countries also have a much higher dependence on agriculture, which will affect the EU's Common Agricultural Policy (CAP). The following table shows the applicants' situation in relation to GDP, population and agricultural employment:

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<sup>19</sup> See BBC Online "France proposes fast EU expansion", 20.11.2001.

<sup>20</sup> Out of 12, as Turkey is not considered to be ready to start negotiations on accession.

<sup>21</sup> Presidency Conclusions, European Council Meeting in Laeken, 14-15.12.2001, paragraphs 7-12.

Table 1: Population, GDP per capita, unemployment rate and agriculture dependency in the Central and Eastern European applicant countries, 2000 (Data Source: Eurostat)<sup>22</sup>

	Population	GDP/cap. current prices and PPS	Agriculture in total employment	Unemployment rate
	Million	As % of EU average	%	%
Bulgaria	8.2	24	13.2 <sup>23</sup>	16.4
Czech Rep.	10.3	60	5.1	8.8
Estonia	1.4	38	7.4	13.7
Hungary	10.0	52	6.5	6.4
Latvia	2.4	29	13.5	14.6
Lithuania	3.7	29	19.6	16.0
Poland	38.6	39	18.8	16.1
Romania	22.4	27	42.8	7.1
Slovak Rep.	5.4	48	6.7	18.6
Slovenia	2.0	72	9.9	7.0

20. The overall scale of the enlargement process is clear from the table. While accession will entail increasing the population of the EU by 28%, GDP per capita in the accession countries is only 40% of EU average<sup>24</sup>. This will result in a drop in average EU GDP to 87% of current EU average. In addition, agricultural dependency in most accession countries is much higher than in the current member states, creating severe difficulties for the organisation of the CAP.

21. While the table above illustrates the scale of the challenge, it does not give an accurate picture of the accession process. Rather, we have to look at the different economic structure of the applicant countries to be able to judge the impact of any wave of enlargement. The following table has been divided between those countries with high relative GDP and relatively low dependence on agriculture (Czech Republic, Estonia, Hungary, Slovakia and Slovenia) and countries with low relative GDP and high dependence on agriculture (Bulgaria, Latvia, Lithuania and Romania). The table shows Poland separately to highlight the importance of that country's accession:

<sup>22</sup> Commission of the European Communities, "Making a success of enlargement", Strategy Paper and Report of the European Commission on the progress towards accession of each of the candidate countries, 2001

<sup>23</sup> Figure taken from the Commission's "First progress report on economic and social cohesion".

<sup>24</sup> Recently, the applicant states also have been struggling with increasing unemployment rates, as noted in the Commission's "First progress report on economic and social cohesion", 2002. On p. 11, the Report notes that unemployment has now reached 12% for the whole region, ranging from 6.9% in Slovenia to 19% in Slovakia.

Table 2: Grouped applicants: Population, GDP per capita and agriculture dependency in the Central and Eastern European applicant countries, 2000 (Data Source: Eurostat)

	Population	GDP/cap. current prices and PPS	Agriculture in total employment
	Million	As % of EU average	%
	<b>29.1</b>	<b>More than 35%</b>	<b>Less than 10%</b>
Czech Rep.	10.3	60	5.1
Estonia	1.4	38	7.4
Hungary	10.0	52	6.5
Slovak Rep.	5.4	48	6.7
Slovenia	2.0	72	9.9
<b>Poland</b>	<b>38.6</b>	<b>39</b>	<b>18.8</b>
	<b>36.7</b>	<b>Less than 35%</b>	<b>More than 10%</b>
Bulgaria	8.2	24	13.2
Latvia	2.4	29	13.5
Lithuania	3.7	29	19.6
Romania	22.4	27	42.8

22. From these figures it is clear that economically the different groups pose very different questions. The first group, while substantially poorer than current EU members, is roughly in line with the current poorest member states such as Greece or Portugal. This group is catching up and integration, while challenging, is not impossible. The second group is in a very different position. Even with high growth rates the catch up process is going to take a long time<sup>25</sup> and dependency on agriculture is very significant. Under the best of 5 scenarios, a Commission paper notes that only “14 of 51 regions would achieve more than 75% of the EU 15 average GDP per capita in 2030.”<sup>26</sup> It is difficult to see how the EU could take these countries in without a very substantial reform of EU systems. Poland is a case on its own. By far the largest population of the applicants would put Poland on par with Spain after accession. However, GDP levels are still low and dependence on agriculture is very high. In the medium term, it is thus the accession of Poland which will provide the real test for the EU<sup>27</sup>. A recent article noted that it is “widely felt, particularly in Germany, that a first batch of new members that excluded the biggest candidate, Poland, would not be worth having. And since Poland is a relative laggard in the negotiations, an enlargement that included the Poles would probably have to include quite a few others that might not, under strict criteria, have been in the first intake.”<sup>28</sup>

<sup>25</sup> In recent years the applicants have grown by more than the EU average for example growing at 4.3% in 1999 and 5.5% in 2000 (see BBC Online “Eastern Europe bucks the global trend”, 21.11.2001). However, the global economic downturn will also affect the applicants, leading to a significant reduction in the growth differential.

<sup>26</sup> Weise et al. “The Impact of EU Enlargement on Cohesion”, 2001, p. 125.

<sup>27</sup> The Commission’s “First progress report on economic and social cohesion”, 2002, notes that in a Union of 25 the least prosperous regions would be located principally in Poland and Hungary (p. 16).

<sup>28</sup> Economist.com “The door creaks open”, 20.11.2001.

## 5) Overall impact of enlargement

23. The impact of enlargement is difficult to estimate, especially since the distribution of effects between the current members and the accession countries, and indeed the distribution within these groups, is likely to be uneven. In this paper, the focus is on the effect of enlargement on current member states with a particular emphasis on trade, investment and linkages. However, the biggest impact is likely to be on the accession countries which will have important knock-on effects on the current member states<sup>29</sup>. It should also be noted that trade liberalisation, as embodied in the Europe Agreements is already having a significant effect, creating opportunities and threats for current members states, as well as applicant countries.
24. The enlargement process is a crucial component of overcoming the post-war divide between Eastern and Western Europe. It creates the historic chance to create prosperous and stable democracies in Central and Eastern Europe, which can take full part in the European political and economic processes. The Prime Minister notes that: "Without enlargement, Western Europe will always be faced with the threat of instability, conflict and mass migration on its borders. Without enlargement, the political consensus behind economic and political reform in the weaker transition countries may splinter."<sup>30</sup> A stable and prosperous Europe is of benefit to all states and regions within Europe. This effect of enlargement is very difficult to estimate but the example of Yugoslavia has demonstrated that the cost of conflict and instability is very high, principally for the people in the areas affected but also for the rest of Europe. Stability and prosperity are a crucial benefit of enlargement and the debate within the current member states should not lose sight of this higher goal.
25. The effect of enlargement is also likely to become more measurable in the medium to long term, rather than immediately. Benefits from trade and investment, as well as increased wealth and competitiveness in the candidate countries, will create a more competitive and diverse Single Market in the EU. In the longer term, economic theory predicts that the static short term trade effects are outweighed by far by longer, dynamic effects. These so-called 'pro-competitive' gains are an essential component of longer term economic gain from enlargement. A discussion paper published by the Commission on the impact of enlargement on SMEs in the Union notes that it is "evident that these [CEE] consumers still have little income at their disposal. Therefore, the macroeconomic impact of the Eastern enlargement will be rather limited for the European Union, at least in the first years after the accession, as the utilisation of growth effects also will need time."<sup>31</sup> However, this should not distract

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<sup>29</sup> In this context, it is worth considering the beneficial effect enlargement has had for Spain, Portugal and Greece. However, the current accession process already has a more profound impact on the CCECs as it is closely linked to the economic reform process and to building economic institutions and frameworks.

<sup>30</sup> Tony Blair, Speech, "Europe's Political Future", Warsaw, 2000. The full text can be found at <http://www.fco.gov.uk/news/speechtext.asp?4913>

<sup>31</sup> Rheinisch-Westfälisches Institut für Wirtschaftsforschung in co-operation with European Policies Research Centre, University of Strathclyde, Glasgow, "Impact of the Enlargement of the European Union

from the short term business opportunities in certain sectors, especially in areas such as infrastructure (transport, energy, water and environment) or services (including financial services).

26. Another crucial component to consider is the position of the EU within the wider global economic environment. With accession the EU is predicted to become the largest exporter in the world<sup>32</sup> having a share of almost 20% of world exports. Intra-EU trade will also increase by a further 9%. This increased status would enable the EU to play an even more prominent role in global economic developments. It should also be noted that without enlargement certain potentially negative effects of economic transition in Central and Eastern Europe could be reinforced. The EU has a crucial role to play to create a 'level playing field', which enables all European countries to trade and invest freely without any one country distorting competition. It also has to be noted that in case living standards do not improve in the accession countries, large scale migration could become a distinct problem. Gros and Steinherr note: "In those countries where reforms do not improve the standard of living, people will vote with their feet."<sup>33</sup> As long as living standards remain low in the accession countries, migration is likely regardless of enlargement. If enlargement can produce a real convergence of living standards, it can contribute to relieve migratory pressures.

## 6) Impact on Scotland

### 6.1) Overall impact on Scotland

27. For Scotland, the effect of enlargement has to be seen in the context of a devolved region within the UK. The effects of enlargement are difficult to track for Scotland in isolation, as the interdependence of Scotland with the rest of the UK and the wider EU will entail that the effects of enlargement on the UK as a whole are also felt within Scotland. The Foreign and Commonwealth Office identifies ten principal effects of enlargement<sup>34</sup> for the UK as a whole:
- Higher economic growth (estimated to be an additional GBP 1.75 billion if the seven largest Central and Eastern European countries join)
  - A larger Single Market (accession of the Central and Eastern Europe countries will bring the size of the Single Market to almost 500 million consumers)
  - Fighting international crime (enlargement will boost co-operation to fight drug trafficking and organised crime)
  - Consumer benefit (access to a wider range of goods and services)
  - A cleaner environment (candidates will have to make improvements to the environment in line with the *acquis*)

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on Small and Medium-sized Enterprises in the Union", November 2000. The full text can be found at [http://europa.eu.int/comm/enterprise/enterprise\\_policy/enlargement/enlarg\\_study.htm](http://europa.eu.int/comm/enterprise/enterprise_policy/enlargement/enlarg_study.htm)

<sup>32</sup>Please see EUROSTAT, Statistics in focus, Theme 6 – 5/2001, "An Enlarged EU – A Trade Heavyweight".

<sup>33</sup>Gros, D. & Steinherr, A. "Winds of Change", Longman, 1995.

<sup>34</sup>The following list is adapted from the list on the FCO's web site and can be found at <http://www.fco.gov.uk/news/dynpage.asp?Page=10639&Theme=19&Template=999>

- Enhanced stability and security (as detailed above)
- Increased international competitiveness (UK companies can benefit from cheaper inputs, a larger and more diverse labour market, technology transfers and economies of scale)
- Fewer pressure for economic migration (increasing wealth in the candidate countries should ease pressure for outward migration)
- Democracy and human rights (the new member states will have to respect human rights and maintain a stable democracy)
- Motor of EU reform (enlargement has already prompted reform in the EU, e.g. Agenda 2000, and further reforms will be necessary)

28. For the current member states of the EU enlargement is estimated to bring substantial economic benefits. Baldwin, Francois and Portes<sup>35</sup> estimate that EU accession of the Visegrad countries will add about 10 billion ecus in real income for the EU-15. They estimate that most of this gain, 70 %, is likely to come to Germany, France and the UK, with about 40 % going to Germany alone. However, the study also estimates that there are significant budgetary costs arising from this enlargement, which outweigh the benefits in the short term. The study concludes that the costs relative to EU GDP in the short term are relatively low as in the longer term EU membership would be enormously beneficial to the economies of the eastern region, as well as current member states. In this context it is important to note that these can only be broad estimates as any budgetary costs will crucially depend on the enlargement negotiations and ongoing policy reforms within the EU.

29. Enlargement will have a significant impact on every part of the EU including Scotland. Trade is already impacting on the current member states and the Europe Agreements have helped EU businesses to expand their market, resulting generally in trade surpluses of the EU with the CEECs. While trade, investment and increased linkages can undoubtedly be beneficial, not all effects will be as positive. Indeed, much of the discussion up to now has been centred on the effect of reduced Structural Funds and the threats to certain sectors of the economy. After 2006, reform of EU regional policy to take account of enlargement may have an impact on Scotland. The ongoing process of CAP reform may also impact on rural areas. The Scottish Council Foundation notes that “The European debate in Scotland seems to focus overwhelmingly on the single issue of funds. However, in reality European policies affecting Scotland are far more wide-ranging.”<sup>36</sup> The Scottish Executive notes that: “The proposed enlargement of the EU will have a number of implications for Scotland. While access to the markets of the new members will be easier, such low-cost regions will pose a greater competitive threat for certain types of inward investment. As enlargement occurs, re-structuring of the EU in areas such as the Common Agricultural Policy and Structural Funds will also impact on Scotland,

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<sup>35</sup> Baldwin, R.E., J.F. Francois & R.E. Portes (1997), “Costs and Benefits of EU Enlargement to the East”, *Economic Policy* 12(24). April.

<sup>36</sup> European Council Foundation paper: *Scotland, Britain & Europe – Diplomacy and Devolution*. The text can be found at [http://www.scottishpolicynet.org.uk/scf/publications/oth16\\_diplom/chapter3.shtml](http://www.scottishpolicynet.org.uk/scf/publications/oth16_diplom/chapter3.shtml)

especially rural areas or areas that currently receive structural funds assistance. In addition, there are growing calls for further liberalisation and economic reforms within EU markets such as financial services, energy and telecommunications.”<sup>37</sup> The message that there are significant opportunities from enlargement despite the threats is reinforced by the Scottish Parliament. The European Committee notes that “Enlargement of the EU is most often reported in Scotland as a process which threatens Scotland’s interests, especially the share that Scotland receives in regional development and agricultural subsidies. Whilst indeed there may be an impact on Scotland’s share of European funding, enlargement also offers a range of opportunities, most obviously trade benefits with the opening of new markets.”<sup>38</sup>

## 6.2) Exports to and investment in the CEECs

30. Trade is one of the major implications of the transition in CEE. However, Scotland and the UK have not been involved in this trade to a major degree: “The EU15’s trade with the CEECs is distributed in a very disproportionate manner. Germany alone accounts for 42% of EU15 exports to the CEECs, while no other member state accounts for more than 10% of the EU15 total. Austria, Belgium, Finland, France, Italy, the Netherlands and the UK each account for 5% or more of the total.”<sup>39</sup> Eurostat data shows that in 1998 the UK only accounted for 5.7% of exports to the applicants and 6.1% of imports, in contrast to the biggest trading partner, Germany, accounting for 42.2% of exports to the applicants and 47.0% of imports<sup>40</sup>. The available data for Scotland (covering manufacturing exports) shows that exports from Scotland reached £466m in 1999<sup>41</sup>, roughly in line with the share of UK exports expected from Scotland’s population share. Of the trade with the applicants, Poland is the largest trading partner with exports reaching £184m, followed by Hungary and the Czech Republic reaching a level of just over £50m each.
31. A study in 1996, commissioned by the then Education and Industry Department of the Scottish Office, already noted that “The UK is a relatively minor trading partner of the CEE countries, though it is a significant partner of some countries such as Poland”<sup>42</sup>. However, in the longer term trade is expected to grow substantially, favoured by increasing prosperity in the CEECs, as well as the opening of markets through the enlargement process. Estimates for trade increases due to enlargement for the EU vary

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<sup>37</sup> Scottish Executive “Scotland: A global connections strategy”, paragraph 3.15, p. 9, 2001.

<sup>38</sup> European Committee of the Scottish Parliament “Report on the enlargement of the European Union and the challenges and opportunities facing Scotland”, paragraph 46, 2002.

<sup>39</sup> Baldwin, R.E., J.F. Francois & R.E. Portes (1997), “Costs and Benefits of EU Enlargement to the East”, *Economic Policy* 12(24). April, p. 131.

<sup>40</sup> Taken from Weise et al. “The Impact of EU Enlargement on Cohesion”, 2001, p. 83.

<sup>41</sup> Figures taken from the SCDI Survey. Please note that this figure includes countries which are not applicants to the EU such as Russia.

<sup>42</sup> The Scottish Office, Economic Research Paper No. 1, “Market Liberalisation in Central and Eastern Europe: Implications for Scotland”, 5/1996.

from 11-18 %, 25 % to even 100 %.<sup>43</sup> Scottish firms are aware of the developments in Central and Eastern Europe. A survey of Scottish firms in 1998 showed that 87% of firms were aware of the accession negotiations. Half of the respondents thought that enlargement offered 'modest' business opportunities, while 30% were 'optimistic',<sup>44</sup>. This is also supported by a recent SCDI survey, which showed that 88% of Scottish firms were either aware or vaguely aware of the EU's enlargement plans with 28% identifying increased trading opportunities.<sup>45</sup>

32. Based on aggregate figures for the trade potential for the UK<sup>46</sup> a Scottish Office discussion paper<sup>47</sup> estimates that Scottish exports could, by 2010, reach GBP 243.5 million annually to Poland, GBP 188 million annually to the Czech Republic and GBP 138 million annually to Hungary. This suggests a high export potential of over GBP 550 million annually for these three countries alone. However, the current situation still falls short of long term expectations. Helen Liddell, the Secretary of State for Scotland, warned recently: "For while enlargement is the EU's greatest opportunity, it is also the greatest challenge for our firms. Orders will not fall into their hands like ripe fruit. To prosper in the Single Market, Scottish business will have to compete with the best in Europe. There is no reason why it should not do so but it will need to be at its innovative best."<sup>48</sup> The main export markets for Scotland in CEE are Poland, Hungary and the Czech Republic. However, the share of all Eastern European countries of Scotland's exports was only 2.4% or GBP 466 million in 1999<sup>49</sup>. Chief Scottish exports have been office machinery, chemicals and whisky.
33. In EU terms, opportunities for commodity trade from current EU members are currently concentrated in certain key areas: Mechanical machinery, electrical machinery, vehicles, plastic and paper products. In terms of service trade the key areas are recycling and environmental services, financial services, equipment rental, computer services and business services.<sup>50</sup> For Scotland, some of the key potential areas for manufacturing trade are in electrical engineering (with the important caveat that most of the firms in this sector are internationally oriented already), paper products, optical-measuring equipment, clothing and textiles. For services, potentially large markets are especially prominent for financial services.<sup>51</sup>

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<sup>43</sup> See p. 10, Rheinisch-Westfälisches Institut für Wirtschaftsforschung in co-operation with European Policies Research Centre "Impact of the Enlargement of the European Union on Small and Medium-sized Enterprises in the Union", November 2000.

<sup>44</sup> Ibid., p. 139.

<sup>45</sup> SCDI "Euro an Enlargement Survey", Q1 & Q3, 2000.

<sup>46</sup> Aggregate figures taken from Baldwin, "Towards an integrated Europe", 1994.

<sup>47</sup> Scottish Office Economic Research Paper No. 1, Raines, P. & Bachtler, J., "Market Liberalisation in Central and Eastern Europe: Implications for Scotland".

<sup>48</sup> As quoted in BBC Online, "Liddell warns on Euro business", 10.10.2001

<sup>49</sup> Figures taken from the SCDI Survey. Please note that this figure includes countries which are not applicants to the EU such as Russia. The latest figures show these exports at GBP 464.9m in 1999/2000.

<sup>50</sup> See p. 41-42 and p. 133, Rheinisch-Westfälisches Institut für Wirtschaftsforschung in co-operation with European Policies Research Centre "Impact of the Enlargement of the European Union on Small and Medium-sized Enterprises in the Union", November 2000.

<sup>51</sup> Ibid., p. 140.

34. One of the areas where in the short term involvement with Central and Eastern Europe in terms of trade and investment is below potential is for the Small and Medium Sized Enterprises (SMEs). The five largest countries in population and GDP terms account for approximately 80 % of all SMEs, with the largest SME sector in Germany, followed by the UK.<sup>52</sup> The importance of SMEs is particularly pronounced in the service sector in industries such as recycling, construction, the sale/maintenance of motor vehicles, wholesale trade, hotels/restaurants, financial support services and real estate services. These services are hard to trade, especially for regions not directly bordering on CEE, but the Internet should enable a higher proportion of SMEs to fulfil their export potential. The effects on SMEs will be more pronounced in the border regions, but this will also entail significant restructuring. In the rest of the EU, SMEs will be less involved in international trade due to high transactions cost. But the lowering of transaction costs for trade and Foreign Direct Investment (FDI) due to enlargement should benefit medium sized firms. The micro-businesses will not be affected significantly as they service predominantly local needs.<sup>53</sup>
35. Reasons for the reluctance for investment and trade involvement can be found through survey evidence. In a 1999 paper<sup>54</sup> for the Association of European Regions of Industrial Technology (RETI), Prof. Dr. Gretschmann uses Western Scotland as one of the case studies to determine the impact of EU enlargement. He uses a survey of experts, which is analysed empirically to arrive at the impact of eastern enlargement. The experts note that trade for the West of Scotland is comparable to EU average and that the main markets of interest are Poland and the Czech Republic. They note that the main benefits from enlargement are expected to come from the trade opportunities the new markets offer, as well as new investment opportunities, while expecting below average gains for the West of Scotland. They note that enlargement is likely to lead to a diversion of FDI to Eastern Europe and that there will be a need for burden-sharing in terms of the EU budget.
36. The Scottish Office economic research<sup>55</sup> paper notes that it is difficult to obtain reliable figures for investment in the CEECs for the UK but the UK is involved in a number of investment projects. However, on an absolute scale, the UK is neither one of the major investors in the region nor does the current investment constitute an important part of UK investment totals (in contrast to, for example, Germany). The paper notes that no detailed statistics exist to differentiate between the UK and the Scottish position.

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<sup>52</sup> See p. 31, Rheinisch-Westfälisches Institut für Wirtschaftsforschung in co-operation with European Policies Research Centre "Impact of the Enlargement of the European Union on Small and Medium-sized Enterprises in the Union", November 2000.

<sup>53</sup> Ibid., p. 50

<sup>54</sup> Association of European Regions of Industrial Technology (RETI), Prof. Dr. Gretschmann, "The Impact of EU-Enlargement on Industrial Regions in Europe", Volume II: Selected Case Studies, 1999.

<sup>55</sup> Scottish Office Economic Research Paper No. 1, Raines, P. & Bachtler, J., "Market Liberalisation in Central and Eastern Europe: Implications for Scotland".

37. The paper notes that market access in terms of exports and investment has been difficult. The paper lists six potential obstacles for Scottish firms:
- Macroeconomic and political uncertainty
  - Deficiencies in infrastructure
  - Legal issues
  - Labour issues
  - Business culture
  - Business information
38. Since the paper was published in 1996 most of these factors have markedly improved in the CEECs<sup>56</sup>. Scottish, and UK, firms can invest in and export to more stable and efficient markets. However, this entails that Scottish firms, supported by the appropriate trade development agencies, need to become actively involved in CEE. The lack of business information is still notable and without this crucial intelligence Scottish firms might fall behind their competitors if no action is taken. The SCDI survey showed that 72% of companies thought that there is a lack of information on EU enlargement, identifying DTI (41%) and Scottish Trade International<sup>57</sup> (20%) as the main appropriate sources of information. 75% of these companies also expressed a desire to see a taskforce in Scotland advising and assisting companies in developing trading opportunities within the EU enlargement area.<sup>58</sup> As more information becomes available<sup>59</sup> and enlargement moves closer, the main drive to open up the applicants' markets for Scotland will have to come from private companies with the public sector and other organisations lending a helping hand<sup>60</sup>.

### **6.3) Competitive threats to trade and investment**

39. It should be noted that the increasing trade with Central and Eastern Europe also carries competitive threats for UK, and Scottish, firms. Grabbe notes that "Many industries in the EU fear that they will lose business to the low wage economies of the applicant countries. This form of wage competition is to some extent already taking place; trade in industrialised products has been broadly liberalised."<sup>61</sup> This is in part driven by the low relative labour costs, which is especially important for low cost

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<sup>56</sup> However, the SCDI "Euro and Enlargement Survey", 2000, identified the strength of sterling as the main barrier (Q5).

<sup>57</sup> As part of the Scottish Executive's Global Connections strategy, STI was merged in 2001 with Locate in Scotland (LIS) to form Scottish Development International (SDI).

<sup>58</sup> SCDI "Euro and Enlargement Survey", 2000, Q8 & Q9.

<sup>59</sup> For example, SCDI launched a 'Business Guide to EU Enlargement' in February 2002 and also provided names of companies which were willing to act as informal mentors to other Scottish companies interested in expanding their trade and investment in the applicant countries. Events, such as a seminar held by the Renfrewshire and Dunbartonshire International Forum on 30 January 2002 to inform companies about opportunities in Poland and Estonia, will also help to encourage Scottish businesses.

<sup>60</sup> The Executive has, for example, introduced a Scottish International Forum in February 2002, which will maximise and improve the promotion of Scotland overseas. It involves Scottish Enterprise, the CBI, VisitScotland, the Scottish Arts Council., the British Council, the Scottish Parliament, the Scotland Office and CoSLA and will be chaired by the Executive.

<sup>61</sup> H. Grabbe "Profiting from EU Enlargement", p. 42

assembly plants. The Commission notes that “Sensitive areas for the Union as a whole could include the Labour Market (though alarmist forecasts would not seem justified), certain industries, especially in labour-intensive and other traditional sectors, some areas of transport, etc.”<sup>62</sup> The SCDI survey showed that in terms of first responses 52% of companies think that there is a threat to competitiveness through cheaper labour costs within enlargement zone countries.<sup>63</sup> The Scottish Office economic research paper<sup>64</sup> notes that important pressures might arise for the mechanical and electrical engineering and chemical sectors in EU countries. However, due to the sectoral composition of Scottish exports the paper concludes that the overall effect of increased manufacturing trade will result in an increase of output.

40. The RETI paper<sup>65</sup> notes the experts in the West of Scotland are concerned about the implementation of EU law in the CEECs and the maintenance of the ‘level playing field’. They are also concerned with the reform of the EU budget and CAP, as well as the capacity in the CEE-5 for self-sustaining growth. They note that in comparison with the applicants, the West of Scotland has competitive advantages in areas such as technology, infrastructure, the commercialisation of university work and a highly skilled, trained and productive workforce, but it might have disadvantages due to high labour costs, location and taxation. The experts expect that relocation of simple West-Scottish processes is inevitable due to lower labour costs, mainly affecting low skilled and unskilled labour, the manufacturing, processing and technology-services sectors. In terms of trade a recent study by the Commission supports this pattern, noting that: “The EU members specialise in the higher price and quality segments of markets with a high content of human capital and R&D, whereas the CEECs specialise in the lower price and quality segments of markets with a lower content of human capital and R&D.”<sup>66</sup>
41. One additional fear that has been expressed is that Scotland will lose out in the competition for foreign direct investment. This is particularly important for investment in the electronics sector, which constitutes 2/3 of total FDI in Scotland.<sup>67</sup> One of the main drivers of economic development in Scotland had been the development of the electronics industry, which has led to parts of Scotland being dubbed the ‘Silicon Glen’. While specific threats can arise to further development through factors such as relative wage differential, the experts in the RETI survey note that the West of Scotland, and by extension the rest of Scotland, is in a relatively good

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<sup>62</sup> Economic impact assessment as part of Agenda 2000, Commission, 1997, as quoted in Avery, G. & Cameron, F. “The Enlargement of the European Union”, Sheffield Academic Press, 1998, p. 151.

<sup>63</sup> SCDI “Euro and Enlargement Survey”, 2000, Q10.

<sup>64</sup> Scottish Office Economic Research Paper No. 1, Raines, P. & Bachtler, J., “Market Liberalisation in Central and Eastern Europe: Implications for Scotland”.

<sup>65</sup> Association of European Regions of Industrial Technology (RETI), Prof. Dr. Gretschnann, “The Impact of EU-Enlargement on Industrial Regions in Europe”, Volume II: Selected Case Studies, 1999.

<sup>66</sup> Weise et al. “The Impact of EU Enlargement on Cohesion”, 2001, p. 86.

<sup>67</sup> See p. 136, Rheinisch-Westfälisches Institut für Wirtschaftsforschung in co-operation with European Policies Research Centre “Impact of the Enlargement of the European Union on Small and Medium-sized Enterprises in the Union”, November 2000.

position given the good transport and telecommunications infrastructure as well as a dense population and industrial network and therefore a high potential for demand. On the other hand, the geographical position is considered to be a disadvantage.

42. While threats to the inflows of FDI into Scotland need to be addressed, it is likely that these threats are exaggerated. The Commission notes that the stock of investment in the CEECs from the EU has reached 27 billion Euro “only a small part of which appears to be driven by low-wage costs in CEE. The major part of FDI is motivated by market access; investment in CEE is created rather than diverted from elsewhere in the EU.”<sup>68</sup> In the longer term, the competitive pressures from the CEECs will lead to improved productivity and competitiveness in Scottish firms. Grabbe notes that “it is not a simple matter of east Europeans taking west European jobs. Rather, cheaper east European workers tend to join a supply-chain, in which they might perform the labour-intensive aspects of production, while workers elsewhere carry out other roles.”<sup>69</sup> The Scottish Executive has recognised that Scottish firms have to be involved internationally. The Executive has published a strategy which aims to lead to “more Scottish companies, organisations and academic institutes becoming active in the global economy through alliances, strategic partnerships, buying and selling technology, trading links and investment overseas.”<sup>70</sup> The RETI paper notes that Scottish firms will react to Eastern enlargement with efforts to increase productivity and increase sales in the CEECs, while noting that further assistance is required through regional economic policy, information campaigns and marketing support.

#### **6.4) Linkages**

43. Scotland has a number of important linkages with the Countries of Central and Eastern Europe. While the Scottish Executive plays an important role in these linkages, it needs to be emphasised that many other public, voluntary and private bodies have also developed crucial linkages. The Local Authorities, and their umbrella organisation, the Convention of Scottish Local Authorities (CoSLA), have developed many direct links to CEECs. The Scottish Parliament is also playing an increasing role. However, in a report its European Committee recognised that “more must be done to increase awareness of the impact of enlargement across Scottish society, highlighting its benefits and the opportunities for improved trade, cultural and civic links between the people of Scotland and our neighbours in Eastern and Central Europe.”<sup>71</sup>
44. One of the areas where Scotland can have an important influence on developments is European regional policy. Scotland is recognised as a frontrunner of the implementation of regional economic policy. Jan Maarten de Vet notes for example

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<sup>68</sup> Weise et al. “The Impact of EU Enlargement on Cohesion”, 2001, p. 135.

<sup>69</sup> H. Grabbe “Profiting from EU Enlargement”, p. 43

<sup>70</sup> Scottish Executive “Radical vision for selling Scotland”, press release, 4.10.2001.

<sup>71</sup> European Committee of the Scottish Parliament “Report on the enlargement of the European Union and the challenges and opportunities facing Scotland”, paragraph 108, 2002.

that “During the 1980’s, and following the innovative examples from the UK and notably Scotland, regional development strategies and plans were prepared as a basis for EU-programmes across Europe.”<sup>72</sup> The importance of these linkages to Scotland were emphasised by Jack McConnell, the then Minister with responsibility for European Structural Funds, at a conference of the East of Scotland European Consortium: “Scotland should see the enlargement of the EU as an opportunity for building relationships and joint ventures with the new members, rather than as a threat to funding.”<sup>73</sup>

45. One of the current visible signs of these linkages is the Scottish Executive’s involvement with the Czech Republic as part of the Twinning initiative of the European Union. In this, sharing experience gained by Scotland in the implementation of European Structural Funds is a useful way of becoming directly involved with accession countries and has led specifically to the development of business links. The Executive is also involved in a Twinning initiative between Finland and Estonia and a number of other Scottish links exist with a range of CEECs. The Executive also takes part in disseminating knowledge through publication on the Structural Fund website<sup>74</sup>, as well as hosting the European Conference on “Evaluation for Quality” in 2000<sup>75</sup> and participating in conferences aimed at developing Structural Funds knowledge in CEECs.

## 7) Conclusions

46. Enlargement will substantially increase the European Single Market but the Central and Eastern European accession countries have a much lower standard of living. The EU has started the reform progress, in terms of institutions and the budget, to accommodate these new member states. The Central and Eastern European Countries face a momentous challenge to become members. They have to fulfil political and economic criteria, as well as transposing the *acquis* into their laws before accession takes place.
47. Due to these challenges, accession is not a foregone conclusion. Some of the countries have made more progress in the accession process than others and the countries furthest behind are in danger of being permanently left behind. In addition, the possible accession of Turkey raises more questions, in terms of political and economic challenges to current EU member states.
48. Overall impact of enlargement is likely to be positive, especially when the following issues are taken into account:

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<sup>72</sup> Jan Maarten de Vet, “EU Enlargement and Preaccession: Reflections concerning Central and Eastern Europe”, Institute of Geography, University of Tartu, Estonia.

<sup>73</sup> Proceedings of the 6th ESEC Conference, “Regenerating Scotland through Europe”, 26 November 1999.

<sup>74</sup> The website can be found at <http://www.scotland.gov.uk/esf/>

<sup>75</sup> Conference proceedings can be found at [http://www.inforegio.org/wbdoc/docconf/edimbourg/edimb\\_en.htm](http://www.inforegio.org/wbdoc/docconf/edimbourg/edimb_en.htm)

- Enlargement can potentially overcome the divide in Europe and reduce conflict across the continent.
  - Long term effects of enlargement are likely to be positive as benefits from trade and investment start to accumulate.
  - The global position of the EU is going to be enhanced especially where trade is concerned.
49. For Scotland the impact is also likely to be positive, in line with the impact in the rest of the UK. These positive impacts include increased growth, fighting international crime, consumer benefits, a cleaner environment and less pressure for migration from the accession countries. There are also particular opportunities for Scotland arising from the enlargement process:
- Enlargement offers a rich potential to increase trade and investment. The realisation of these benefits will in part depend on available information and public policy has a role to play in this area.
  - There are strong linkages developing with Central and Eastern Europe, which can facilitate beneficial exchange.
50. Fears have been expressed that enlargement will result in job losses in the current member states as trade and investment locates in the new member states. While this might be true for certain sectors, in general the threats from enlargement to the Scottish economy are likely to be relatively low due to structural differences between Scotland and the CEECs. Furthermore, the re-direction of trade and investment flows is part of the globalisation process, which would take place irrespective of enlargement.
51. Overall, the potential benefits far outweigh the potential threats and Scotland needs to engage actively with the applicant countries and with Scottish businesses to ensure that objective information is available to realise the available opportunities.

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