

# **Dealing with Diversity: The Challenges for Europe**

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## 1. Introduction

Article A of the Treaty on European Union states that the Union's aim is to create an "ever closer union among the peoples of Europe". Article B sets as one of its primary objectives "to promote economic and social progress [...], in particular through the creation of an area without internal frontiers, through the strengthening of economic and social cohesion and through the establishment of economic and monetary union, ultimately including a single currency." These articles encapsulate the EU's very basic philosophy, which is to promote convergence through economic integration and the adoption of common legislation and policies.

By and large, Europe has been surprisingly successful in this quest for convergence. Most indicators point to a significant reduction of disparity among the member states. This applies to income per capita (both for the initial members and for the so-called "cohesion countries");<sup>1</sup> to industrial structures and trade patterns (the single market has not led to specialisation along comparative advantage, but rather to the development of intra-industry trade cum vertical differentiation);<sup>2</sup> to the structures of micro-economic governance (as embodied in Community legislation, e.g. competition policy rules and principles for the provision of public service); and to macro-economic priorities and performance (especially inflation and fiscal policy, for which the EMU treaty provisions and corresponding secondary legislation set forth numerical targets). Maastricht can be seen as a major milestone in this long-standing process of convergence. Areas of non-convergence remain, but are essentially limited to the realm of the state, and the field of industrial relations: tax policies, social insurance, and more generally the provision of public goods may be mentioned, as well as labour market policies and performance. However, there are signs that convergence might be beginning to take place in these fields too.<sup>3</sup>

The question addressed to Europe since the beginning of the 1990s is whether and how this philosophy remains compatible with the new task of promoting integration among increasingly diverse countries, while fostering the catching up of the poorer members. Europe's agenda is indeed daunting. It involves, in more or less chronological order,

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<sup>1</sup> See Table 1 below.

<sup>2</sup> This was a prominent result of the evaluation of the impact of the Single Market undertaken by the EU Commission in 1996. See Fontagné and al. (1997).

<sup>3</sup> The Luxemburg Council of November 1997 set out common objectives and broad guidelines for employment policies. It may have initiated a process of (weak) convergence in the field of labour market policies. Tax policy approximation is also receiving increasing attention in intergovernmental discussions. More generally, competition in goods, services and factor markets is increasingly fostering convergence in fields that were previously considered free from the pressure of European integration.

- implementing the (minor) revisions to the decision-making process agreed upon in Amsterdam as a result of the 1996-97 negotiations on institutional reform ,
- establishing monetary union among a subset of countries,
- negotiating enlargement to five Central and Eastern European Countries (Estonia, Hungary, Poland, the Czech Republic, Slovenia) and Cyprus,
- revising the Structural Funds and the Common Agricultural Policy (CAP),
- achieving free trade in non-agricultural products with Mediterranean countries,
- and more generally fostering development and trade opening in the Union's periphery.

The official view among European policy-makers is that the EU can cope with these tasks at a relatively low cost. According to this view, Europe basically needs: (i) to streamline its decision-making machinery (through reforming the weighting of countries in voting rules, enlarging the scope for majority voting, and reducing the number of commissioners); (ii) to reform the CAP and the Structural Funds with a view to reducing their budgetary cost and facilitating upcoming enlargement negotiations; (iii) to negotiate with Central and Eastern European Countries an enlargement agreement that includes temporary derogation from the single currency and part of the single market, as well as a cap on budgetary transfers. (i) Was expected to result from the negotiations which took place in the Inter-Governmental Conference (IGC), but since these negotiations did not reach an ambitious agreement on institutional reform, further discussions on strengthening the European institutions are now supposed to take place before enlargement takes place; (ii) is supposed to be completed through implementing the so-called "Agenda 2000" programme; (iii) should result from the upcoming negotiations.

Even this limited agenda is an ambitious one. Negotiations at the IGC have been notoriously difficult and the results reached in Amsterdam are widely considered modest. Reforming the CAP and the Structural Funds, which taken together amount to 80% of the Community budget, is bound to give rise to significant distributional conflicts both among and within member states. And completing successfully enlargement negotiations will be a far more demanding task than for previous enlargements. But a more fundamental question is whether a Union that would stick to this limited agenda would be well enough equipped to cope with the challenges it is committed to address. This paper argues that there is a significant chance that it would not.

## **2. Economic and Monetary Union**

Take Economic and Monetary Union first. As things stand now, it is likely that it will start on schedule with a majority of member states. However, two countries (the UK and Denmark) benefit from an opting out clause, and at least the UK is likely to exert it. Sweden was later granted a similar option and has indicated its intention to abstain from monetary union, initially at least. Greece will not fulfil the criteria for membership, and at the time of writing controversies about Italian membership have not entirely disappeared. It should also be noted that although formally committed to participate in monetary union, any member state could escape this obligation through abstaining from membership in the Exchange Rate Mechanism (in which participation was deemed voluntary by the European Council). Since participation in the ERM is one of the criteria for entering the single currency, abstention from it would ensure that the country would never fulfill the conditions for membership. The Maastricht treaty notwithstanding, monetary union has thus been made an optional partnership. Whether or not it will subsequently enlarge to new members and eventually encompass virtually all the EU15 cannot be assessed with any certainty, since this will depend on each country's assessment of the costs and benefits of membership as well as on complex dynamic interactions between the 'ins' and the 'outs'.

Furthermore, participation in EMU of the accessing countries from Central and Eastern Europe is likely to be delayed, because freezing nominal exchange rates prematurely would be for the CEECs a recipe for severe difficulties along their transition and catching up process. As demonstrated by several countries in transitions, fixed exchange rate strategies have an appeal in the early stages of transition, but at some point in time there is a need for introducing more flexibility, if only because of the uncertainty surrounding the level and the evolution of the equilibrium real exchange rate. The conclusion is therefore that in spite of the "one market, one money" logic, membership in monetary union will for a long time be narrower from membership in the Single market.

Would such a two-speed integration give rise to prolonged differentiation, over and above what is envisaged in the Maastricht treaty? In spite of a growing body of research devoted to the economics of two-speed monetary integration, it is difficult to reach firm conclusions, because the creation of a monetary core will set in motion both centripetal and centrifugal forces (see Pisani-Ferry, 1998, for a survey of this literature). There are however two main reasons why

a lasting divide could emerge. First, the possibility must be contemplated that economic or political divergence could make temporary abstention or exclusion more lasting than currently anticipated. Countries not participating in EMU could embark on a divergent policy course, thereby increasing rather than reducing the cost of convergence (Martin, 1995). The commitment to tight fiscal discipline embodied in the Stability (and Growth) Pact that was agreed upon by the European Council in Dublin in December 1996 increases the likelihood of such a divergence between the 'ins' and the 'outs'.

Second, there is a possibility that the specific policy externalities created by monetary union will nurture closer coordination among the member of the euro core, in fields like fiscal policy, taxation, banking supervision, labor standards, etc., plus, may be, in establishing specific stabilization or transfer schemes.<sup>4</sup> Since the project was launched, economists have been discussing the need for such coordination, stabilization or redistribution schemes, as well as for 'political union' in a broader sense, without leveling out their differences and reaching firm conclusions. But at French insistence, the European Council eventually recognized in December 1997 the need to create a policy forum for the ministers of Finance of the 'ins' (the so-called Euro-x), thereby giving its blessing to the idea that closer coordination will be needed in a monetary union. We cannot therefore rule out a scenario in which the subset of countries participating in monetary union would embark on a much deeper integration course, while those watching monetary union from the outside would eventually choose to abstain from this 'ever closer union'.

The EU has barely begun to come to terms with this possibility. The successor to the Exchange Rate Mechanism whose creation was decided at the Dublin Council of December 1996 is merely a purgatory for EMU applicants. It is not a long-term solution for organizing the monetary coexistence within the single market, because participation in it will require a high degree of nominal convergence.<sup>5</sup> Recognizing that not all EU members will take part in the single currency should rather imply laying down what kind of exchange rate policy is deemed compatible with membership in the single market.<sup>6</sup> In other words, there is a need to define rules

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<sup>4</sup> This is a highly disputed issue. See, for example, Fatas (1997).

<sup>5</sup> In community jargon, it is an attempt at organizing relations between the « ins » and the « pre-ins », not between the « ins » and the « outs ».

<sup>6</sup> Whether membership in the single market requires some form of exchange rate discipline is a matter for discussion. In a recent paper, Eichengreen (1996) argues that while the *economic* link between the single market and the single currency is not strong enough to make participation in monetary union mandatory, there is a strong

of conduct for those member states which have no intention of participating in the single currency: what exchange rate discipline will they have to abide by, for their macroeconomic policy to be considered compatible with membership in the single market? What kind of arrangements will the Union offer to those which have an intention to apply for membership in the single currency, but for which it is still a very distant goal? These questions have not yet received precise answers.

The conclusion from this analysis is that monetary union raises more fundamental questions than the previous stages of integration. There are deep reasons for that: although standard trade theory states that trade liberalisation and facilitation are unambiguously beneficial for participating countries (and therefore that exemption clauses can only be justified on a temporary basis), macroeconomic and monetary theories do not lead to similar statements as regards monetary union. Furthermore, participation in fixed exchange rate regime or a monetary union is *by nature* voluntary. There is therefore no overriding reason to assume that monetary union will soon encompass all the member states of the Union.

### **3. Enlargement to the East**

The prospective accession of the CEECs should also transform the nature of the EU in a fundamental way. The Community started as a group of highly homogenous countries as regards their relative development level, with GDP per capita in the poorest country (Italy) reaching 70% of that in the richest (Germany).<sup>7</sup> This ratio dropped to 40% after the accession of Ireland and Greece (in the 1970s) as well as Portugal (in the 1980s), but in 1995 population in the so-called ‘cohesion countries’ (Spain, Portugal, Greece and Ireland) totalled 17% of the Union’s population (and only 6% excluding Spain, whose relative development level is roughly comparable to that of Italy in the 1960s). The accession of Poland (assuming it would take place in 2005 after some catching-up) would lead the ratio to drop 30% and that of Romania (in 2015) would further reduce it to 20%. Table 1 illustrates that even assuming that the Community will continue to function as a convergence machine, enlargement will dramatically reduce its homogeneity. As Andras Inotai (1996) put it, with its enlargement to the East the Community

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*political economy* link between the two. This is because participation in the single market implies that member states deprive themselves from all contingent protection instruments and abide to the Commission rulings in the field of competition policy.

<sup>7</sup> Data refer to 1960 GDP per capita at PPP exchange rates. Source: CHELEM-CEPII.

will have to deal with "integration through development" rather than "integration through the market."

**Table 1: Disparity within the EU**  
(Unweighted Coefficient of Variation of GDP per Capita, PPP Exchange Rates)

	1965	1975	1985	1995	2005	2015
EC6 <sup>a</sup>	<b>10.0</b>	6.8	5.1	2.3	2.5	3.3
EC9		<b>16.9</b>	16.1	9.4	8.8	7.7
EC12			<b>26.2</b>	21.9	21.1	18.1
EU15				<b>19.5</b>	18.8	16.2
EU21 <sup>b</sup>					<b>32.1</b>	26.8
EU28 <sup>c</sup>						<b>42.2</b>

a. with Belgium and Luxembourg counted as one country ; unified Germany replaces West Germany from 1991 on.

b. EU15: plus the Czech Republic, Hungary, Poland, Slovakia, Cyprus and Malta.

c. EU21 plus the three Baltics, Albania, Bulgaria, Romania and Slovenia.

Note : bold characters indicate data at the time of successive enlargements; the first and second enlargements are supposed to have taken place in 1975 and 1985 for the sake of simplicity.

Source : CEPPII-CHELEM Databank and EBRD (1995) for observed data. Delessy(1996), and author's calculations for long term projections.

These transformations are bound to deeply affect the scope of internal transfers through the Structural Funds and the CAP. Recent academic estimates of the net budgetary cost of enlargement (i.e., the cost to the current members of the EU), which take into account both the impact of past and prospective impact of CAP reform, and constraints to the absorption of transfers on the receiving side, come up with more conservative figures than the earlier estimates: according Baldwin and al. (1997), this cost would range from ECU10bn to ECU20bn for the four Visegrad countries and Slovenia, instead of the ECU60bn envisaged in earlier studies.<sup>8</sup> Further enlargement to Balkan countries and the Baltics could increase this cost by at least 50%. These are certainly trivial figures from an historical perspective. Furthermore, the level of structural transfers to the new member states of the EU will result from a political decision, rather than from the mechanical replication of previous schemes, and as indicated by the Agenda 2000 programme, the current attitude towards budgetary transfers suggests that the EU will attempt at avoiding increasing the ceiling for Community expenditures. As the above figures would certainly imply a significant increase (by 15-30%) in the contribution of the

<sup>8</sup> The extrapolation of per capita Structural Funds spending by Courchene and al. (1993) led to a net cost of ECU26bn. Anderson and Tyers (1995) put the cost to the agricultural budget at ECU37bn.

incumbent countries to the EU budget, save severe restrictions in transfers to the EU farmers and the incumbent poor countries, this is an indication that enlargement will certainly give rise to protracted controversies. The political cost of reforming the EU budget will not be trivial.

Focusing on the budgetary implications of enlargement to Central and Eastern Europe however misses a much more complicated issue for the forthcoming negotiations: the conditions of CEE participation in the single market. The Community started in the 1950s with an ambitious political goal but a less ambitious economic commitment to gradually liberalise trade in goods, and put specified sectoral policy areas under Community guidance: this was, after all, the essence of the Monnet doctrine. Even putting aside monetary union, the Community of the 1990s is a far more ambitious venture. It involves, at least in principle, the dismantling of border controls and the renunciation to any form of contingent protection; unfettered capital and labour mobility; a near-complete liberalisation of trade in services, including part of the traditional realm of public services; common rules for and Commission authority over competition and state-aids policy; the opening of public procurement; a partial harmonisation of indirect taxation; and a large body of economic legislation aiming at a achieving a sufficient degree of harmonisation of national policies to implement mutual recognition of technical, environmental and sanitary standards, health and safety regulations, and labour standards. This is the inheritance of the single market programme, which came into existence as the result of a major effort that mobilised the energy of the Community during a decade, and still arises controversies in some member states as it implies introducing competition in traditionally sheltered sectors. In spite of the extraordinary changes that have taken place in Central Europe, to what extent countries in the midst of their take-off should participate in this system is debatable. Although no comprehensive study is available, several scholars have already expressed concern in this respect (Baldwin 1994; Fingleton *et al.*, 1995; Smith *et al.*, 1996; Economic Commission for Europe, 1996; von Hagen, 1996; Sgard, 1996; Baldwin *et al.*, 1997). A few points can be put forward.

The first issue is the administrative cost of implementing the single market in the CEECs. The Commission services reckon it will require the adoption of hundreds of pieces of economic legislation, even taking into account possible restrictions on the definition of the *acquis communautaire*. This is bound to be a significant burden for countries not yet equipped with fully-fledged market systems, and without the administrative resources that would ensure proper implementation. As already recognised by the Commission, institution-building on a large scale



will be required. Monitoring the effective enforcement of such a large body of legislation in an increasing number of countries is also bound to be a very demanding task for the Commission. Difficulties in implementing the 1995 Community White Paper on preparations for the accession of the CEECs confirm the size of the task.

The second and more profound issue is whether swift and complete adoption of the single market legislation is advisable from the point of view of the transition countries. Implementing a legal and regulatory framework that was explicitly designed on the assumption that all participating countries had reached a high level of development (this was after all the rationale behind the "new approach" to regulatory policy, which put emphasis on mutual recognition rather than harmonisation) could involve suboptimal social choices. A clear distinction must be drawn here between different types of legislation:

- adopting Community product quality and safety standards will anyway be required for exporting to the EU market; in this respect, efforts towards upgrading these standards will be conducive to the CEEC's competitiveness; but the participation in the single market would require that all goods (including those for domestic consumption) would be subject to the same requirements; this may be undesirable for the least advanced of the CEECs, whose consumers may value quality and safety less than the affluent citizens of the EU;
- harmonisation of process regulations, e.g. in fields like the environment or working conditions, is not required for giving to the CEECs full access to the EU market; it would only result from the application of existing EU legislation, and could conflict with the associated countries' own social choices (because the implicit value of, e.g., environmental goods, depends on the level of income); it could even significantly hamper the catching up process; but the coexistence of different standards within the single market (in fields like the environment or social legislation) would almost certainly be challenged by producers from the incumbent member states on grounds of unfair competition;
- most of the CEECs have already adopted the principles of EU competition policy, and there is no doubt that this was part of the basic toolbox of a market economy; however, full implementation of the EU's competition and state aids apparatus might be excessive (Fingleton *et al.*, 1996).
- it is questionable whether full capital market liberalisation and full liberalisation of the market for services should be implemented at the current stage of the transition process.

The third issue relates to the effect of a full participation by the CEEC in the single market on the incumbent member states of the EU. A prominent topic in this respect is obviously labour mobility, since the incumbents are likely to insist on controlling migration inflows for a prolonged period. This will prevent the accessing countries from participating in the Schengen

arrangements. But the incumbents will certainly resist full participation of the CEECs in other fields in which uncertainty as regards the actual implementation and enforcement of Community rules would undermine the very principle of mutual recognition. As noted by von Hagen (1996), financial services are a case in point: integrating into the single market for financial services a country whose banking system is perceived as fragile could undermine the confidence of the general public in the financial system as a whole. Similar difficulties could arise for consumer products safety, sanitary or environmental standards, as well as for the operation of the VAT system, which is already subject to fraud (Lefèbvre and Guichard, 1997). The « mad cow » disease has illustrated how quickly member states could revert to national standards when health and safety are at stake.

Obviously, individual CEECs are in very different situations with respect to these issues. There is much variance in the quality of the government machinery. Some countries are already well advanced in approximating their economic legislation to that of the EU, while other are still striving to create the basic institutions of a market economy. There are also considerable differences as regards for example the enforcement of tight budget constraints on ailing companies and the separation between credit and subsidisation. But the above issues have at least some relevance for all potential applicants. For countries whose transition strategy relies heavily on government intervention, the gap between the present situation and the single market principles is simply too wide to be bridged in the near future.

Solutions to these dilemmas are already under discussion. One possibility would be to distinguish between those pieces of legislation that are deemed essential for the functioning of the single market, and those, which can be temporarily put aside. This approach would result in defining, within the *acquis*, a "core" which the CEEC would need to implement fully in order to be able to participate in the single market without disrupting it (Portes, 1996). A second approach could be to enlarge the EU while 'exempting' the new member states from full participation in the single market through 'temporary derogations', i.e. to include them *de jure* as full members of the Community, while limiting *de facto* their participation to membership in a customs union without, e.g., removing border controls, achieving mutual recognition or implementing freedom of provision of services. Both approaches would imply defining a number of transitory derogations which would apply for a specified time period.

Both approaches have the merit of trying to remove obstacles to early accession. In fact, the worst-case scenario would be West European procrastination leading to East European discouragement. By laying down conditions for membership (at the European Council of Copenhagen) and a timetable for negotiations (at the Madrid Council), the EU has created expectations, and it should be careful not to disappoint them. Neither approach is however really satisfactory. The ‘core *acquis*’ approach is likely to be very difficult to implement, because what is at stake is the definition of the essential conditions for a proper functioning of an integrated European economy without border controls. Excluding part of the existing legislation, for example as regards some state aids, public procurement, or labour and environmental standards, would certainly give rise to a flurry of controversies in the name of competitive distortions, and probably lead to question the rationale for having included these provisions in the Community law. Furthermore, even an *acquis* limited to its core provisions would represent a significant challenge for the applicant countries. Including adoption (and enforcement) of the core *acquis* among the conditions for membership would at least result in delaying significantly the accession of part of the CEECs. At worst, it would create a permanent divide between the ‘ins’ and the ‘outs’ of accession, and could contribute to put some countries on a divergence path (Martin and Ottaviano, 1995).

The risk of divergence could be significant since the EU has not yet been able to offer the CEECs an attractive alternative to full membership. It should be reminded that the Europe Agreements currently in place do not include a commitment by the EU to the eventual admission of the associated country; that contingent protections remain in place for industrial goods (the EU has only indicated that it could reduce contingent protection, subject to "satisfactory implementation [by the CEECs] of competition and state aids policies [...] together with the wider application of other parts of Community law",<sup>9</sup> and that market access remains restricted for agricultural products; and that participation in the Europe Agreements does not give to the applicant any form of participation in Community decisions<sup>10</sup> (see Annex Table A1). The alternative to membership is thus simply to remain an outsider. The creation of a European Conference, which was decided at the European Council in Luxembourg, is recognition of the existence of a problem. It is not (not yet, at least) a solution.

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<sup>9</sup> 1995 White Paper on the preparation of the associated countries, quoted by Smith *et al.* (1996).

<sup>10</sup> Even Turkey, who is now formally in a customs union with the EU, has not gained participation in decisions as regards the common trade policy. See below

The 'temporary derogation' approach conforms the Community tradition, as it was used on the occasion of previous enlargements, but at a smaller scale and for shorter periods than would be necessary in the case of the CEECs: the single market risk was not yet in existence when Spain and Portugal became members of the Community, and the EFTA countries had already adopted most of the corresponding legislation when they entered it in 1995. Relying on the same approach would risk creating an extremely complicated and opaque system in which some member states would benefit (or suffer) from tailor-made derogation while having a vote on the definition of the same policies from which they are exempt. As Baldwin et al. (1997) emphasise, the Community experience shows that as can be expected in a system based upon majority voting, the inclusion of new members tends to tilt policy decisions towards their interests. Having the CEECs both within and without the single market would be a recipe for clouding the decision process, as if countries in the ERM were participating in the monetary policy decisions of the European Central Bank.

#### **4. Turkey and the Meds**

The perspective of enlargement has given rise to a revival of the EU's Mediterranean policy, which under the pressure from some member states felt obliged to design a strategy towards its Southern flank. This commitment was highlighted at the Barcelona conference of 1995, and resulted in the EuroMed agreements, the first of which was concluded in 1995 with Tunisia. The aim is to create an Euro-Mediterranean free trade area (for industrial goods) by 2007. But there were deeper reasons for such a policy than a mere concern for (artificial) symmetry. The EU's Southern neighbours are demographically dynamic, but economically fragile and politically unstable. Although there have been some success stories, the Mediterranean region is lagging behind more dynamic areas of the former developing world, and the EU has reasons for being concerned with the risks of a development failure on the other side of the Mediterranean. Furthermore, the US initiatives towards Mexico and the Americas have highlighted the need for a European trade and development strategy towards the Mediterranean region.

Turkey is a different case because it is a candidate to accession and since 1996 is part of a customs union with the EU (of which it is the sole non-EU member). Whether or Turkish accession can be contemplated is a contentious issue: some member states have clearly indicated

their reluctance towards it, but the Turks are adamant that they should not be denied the right to membership. The Luxembourg Council of December 1997 confirmed that Turkey is in principle eligible for membership, but it did not decide to open accession negotiations.

The EU's policy towards the Mediterranean region is problematic for two reasons. On purely economic grounds, the commitment towards liberalisation enshrined in the recent agreements is highly asymmetric because the EU has not made any significant move towards liberalising access to its agricultural market, while the Meds are committed to fully liberalise their markets for industrial goods. In spite of the upgrading in Community assistance towards the region, this is likely to create difficulties (Bensidoun and Chevallier, 1996). Furthermore, the nature of the partnership offered by the EU is unclear. As indicated by Table A1, the association agreements concluded with Central and Eastern Europe and the EuroMed agreements, as well as the Customs Union agreement with Turkey, have several features in common. But they differ in many details, and most notably as regards the end-goal of the association with the EU. These differences highlight the hub-and-spoke nature of the EU's trade agreements and the lack of a general concept for integrating countries with different historical backgrounds and at different stages of economic development. This strikingly contrasts with the approach adopted in Asia, where APEC encompasses very diverse countries with different attitudes towards trade liberalisation, while setting common goals that each member commits itself to pursue (Drysdale, Elek and Soesastro, 1997). Whereas the limits to the non-institutional approach to integration prevalent in Asia have been made apparent by the currency and financial crises of 1997, this is no reason for not drawing on the achievements reached in this region.

## **5. Is there an alternative strategy?**

Summing up, both monetary union and enlargement raise similar concerns: (i) for a undetermined time period, it is unlikely that all potential applicants will be able to fulfil the criteria for admission; (ii) premature admission of new members could both be detrimental to them and also lead to disrupting the functioning of integration; (iii) deeper integration creates new channels of interdependence and specific needs for policy coordination or harmonisation, which should be best dealt with among the participants, without involving the outsiders; (iv) excluding applicants without offering them a stable and clearly designed form of partnership

would create resentment and might lead the 'outs' to embark on a divergent path. In addition, the EU faces pressures to better organise relations with neighbouring Mediterranean countries.

The search for a method for addressing the new challenges of integration should start from the recognition that diversity in the willingness and the ability to participate in European integration is here to stay. Instead of offering a single model for membership, the EU could explicitly acknowledge the existence of several possible levels of integration and adapt its institutional scheme in order to make possible the coexistence of different integration circles. This 'variable geometry' approach does not imply a degeneration towards an *Europe à la carte*, in which each member would be able to pick up its favourite items without having to enter compromises with the others, as long as it is based upon a clear concept for flexible integration. On the contrary, it involves the definition of a *Europe au menu*, in which member states would be offered a limited number of clearly defined options. In order for the system to be viable, each integration option should include the bundle of those policy competences that are necessary to make it sustainable.

The two main models for organising integration in this way are (i) the integration circles approach and (ii) the open partnership approach. The first scheme is inspired by the desire not to create a division between the elite and second-class member states. According to this approach, which was proposed by CEPR (1995), all countries would participate in a "common base" (essentially the single market) and would be free to enter into specialised "open partnerships". The second scheme derives from the "core" approach à la Lamers-Schaüble (1994), which could lead to the formation of concentric economic integration circles as developed in Pisani-Ferry (1995).<sup>11</sup>

The appeal of the open partnership approach is that it offers a simple and clearly organised model. Its first drawback is its inherent contradiction between limiting Community integration to the single market status quo and attaching all supranational features to it. As any comparison between the EU and existing free trade areas confirms, the Community institutions were created in view of more ambitious aims than ensuring the smooth operation of the single market. If the common base were to be limited to the management of existing integration areas, the Community system (especially the Court of Justice and the Parliament) might soon prove superfluous. Symmetrically, building a monetary union through purely intergovernmental

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<sup>11</sup> Whether or not a potential defence and security circle would also be concentric is different

arrangements might well lead to difficulties. The German debate on the need for parallelism between monetary union and political union highlights what is at stake in transferring monetary competences to a European Central Bank (Issing, 1996). Furthermore, there is a discussion on the implications of monetary union in the budgetary sphere, and it is sometimes envisaged that monetary union could give rise to increased fiscal coordination and the creation of quasi-federal income stabilisation schemes (Courchene and al., 1993). If this were to happen, limiting supranationalism to the common base would clearly be unsustainable. A second drawback of the open partnership approach is that it does not offer a solution for potential member states that would face difficulties in becoming full members of the single market.

The alternative approach, that of integration circles, starts from the recognition that integration does not start with the full participation in the single market and does not stop with it. It attempts at providing a scheme for organising the coexistence of different levels of integration through adopting and replicating at a lower level the Maastricht approach to monetary union. To each level would correspond a set of laws and specific decisionmaking mechanisms, in which all countries participating in that level would have a vote. Graduation from one level of integration to the next one would neither be mandatory nor automatic. It would require both a voluntary decision by the applicant and the fulfilment of a precisely defined set of criteria, as already decided for membership in monetary union.

The Union could thus comprise three integration levels: the customs union, which could quickly encompass virtually all the CEECs, which would in this way acquire membership status with all its political implications; the single market, that would comprise all present member states and the most advanced of the CEECs as soon as they are able and willing to abide to the corresponding disciplines; and monetary union, in which membership could remain limited for a protracted period.

- Participation in the customs union would be open to all European countries that (i) fulfill general criteria and (ii) are willing to adhere to the Community's aims and to implement corresponding policies (such as, e.g., essential components of competition policy). It would grant its members full access to the Community goods market (but without the complete removal of border controls nor the freedom of movement of factors), as well as participation in most of the Community's structural policies (such as infrastructure and regional development policies). Agriculture obviously gives rise to specific problems, but in principle there is no reason why agriculture should not be part of the customs union arrangement. Trade conflicts would be subject to dispute settlement within the framework of Community law. Participation in the customs

union would imply contributing to the Community budget and having access to Community regional development programmes, but specified budgetary funds could be restricted to participants in the single market level or the Economic and Monetary Union level (as is currently the case for the cohesion fund).

- Participation in the single market, i.e. in the Community as it is prior to the formation of monetary union, would be decided upon on the basis of specified criteria (that would refer to the adoption of Community legislation in all fields which are deemed essential for the functioning of the single market, including process regulation, state aids, etc..) and be subject to vote as it is the case for EMU. It would give access to full participation in all Community policies except monetary union.
- Participation in monetary union would finally remain subject to the fulfilment of specified convergence criteria.

Such an approach would have several advantages: (i) it would remove most of uncertainty as regards accession; (ii) for the CEECs, participation in the customs union would be a significant improvement on the present situation, because it would grant them voting rights as well as wider access to EU funds, and would remove the essentially bilateral, hub-and-spoke nature of current trade arrangements; (iii) instead of overloading pre-accession programmes with conditions required for participating in the single market, preparation for the single market would become part of a post-accession strategy; countries willing to develop economic and political links with the EU would not be obliged to choose between being out and participating fully in European integration.

Apart from its distance from existing commitments, this approach also has significant drawbacks. It would require creating different tiers of legislation. It would imply difficulties in achieving coexistence between countries belonging to different integration circles. And a three-tier system would create difficulties for the operation of supranational institutions, and might give rise to institutional confusion (the difficulty could be especially serious as regards the European Parliament). However, there is no easy way out of these problems which arise as soon as a form of variable geometry is contemplated. The underlying reality is that the Community's homogeneity is a thing of the past (Emerson, 1998). Rather than striving to adapt diverse countries to a single European integration model, there is a case for adapting the integration model to the diversity of the Europe of today.



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## Trade Agreements with the EU: CEECs, Turkey and the Meds Compared

	Association Agreements	Turkey-EU Customs Union	EuroMed Agreements
<b><i>Principles and Aims</i></b>			
Date	· First agreement with Hungary 1991	· Principle agreed 1964, agreement 1995  · Created 1/1/1996	· First agreement with Tunisia 1995
Countries	· 10 Countries from Central and Eastern Europe and the Baltic	· Turkey	· 3 Maghreb + Egypt, Jordan, Israel
Nature and aims	· FTA  · Agreements meant to prepare for eventual accession	· Customs union  · Disagreements over possible accession	· FTA  · EuroMed partnership and free trade, no accession envisaged
Institutions	· Association Council	· Association Council	· Association Council
<b><i>Tariff and Nontariff liberalisation</i></b>			
Non-agricultural goods	· Elimination of all duties (phased out over 5 years for EU, over 10 years for CEECs) and of most QRs after transition period  · Cumulative rules of origin for Visegrad / Balkans / Baltics (but not accross groups)  · EU contingent protection remains in place, could be reduced after the CEECs adopt EU competition and state aids policy	· Removal of QRs, and of technical barriers within 5 years  · Adoption by Turkey of EU common external tariff with limited exceptions (5% of Turkey's imports)  · Adoption by Turkey of EU trade policy instruments and preferences  · EU anti-dumping to remain in place for interim period	· Meds already access EU market duty-free, no further commitment to eliminating QRs and contingent protection  · Med liberalisation completed in 12 years (end 2008)  · Cumulative rules of origin for Maghreb only  · EU contingent protection remains in place
Agriculture	· Partial liberalisation	· Turkey committed to adopting CAP rules, but without time constraints	· No progress
<b><i>Capital, Labour and Services</i></b>			
Capital flows, FDI, right of establishment	· Commitment to capital account liberalisation	· No agreement	· Commitment to capital account liberalisation « when time right »

	<ul style="list-style-type: none"> <li>· Liberalisation of FDI and profit repatriation</li> <li>· Free entry within 10 years + national treatment in most sectors</li> </ul>		<ul style="list-style-type: none"> <li>· Liberalisation of FDI and profit repatriation</li> <li>· Right of establishment to be covered by subsequent agreement</li> </ul>
Migrations	<ul style="list-style-type: none"> <li>· No liberalisation</li> </ul>	<ul style="list-style-type: none"> <li>· No liberalisation</li> </ul>	<ul style="list-style-type: none"> <li>· No liberalisation</li> </ul>
Services	<ul style="list-style-type: none"> <li>· Weak commitment to liberalisation</li> <li>· Cooperation and TA in specific sectors</li> </ul>	<ul style="list-style-type: none"> <li>· No agreement</li> </ul>	<ul style="list-style-type: none"> <li>· No specific commitment (reference to GATS)</li> <li>· Cooperation and TA in specific sectors</li> </ul>
<b><i>Deeper Integration Provisions</i></b>			
Intellectual property	<ul style="list-style-type: none"> <li>· Adoption of international provisions within 5 years</li> </ul>	<ul style="list-style-type: none"> <li>· Swift implementation of international provisions (within 3 years or less)</li> </ul>	<ul style="list-style-type: none"> <li>· Adoption of international provisions within 4 years</li> </ul>
Competition policy and state aids	<ul style="list-style-type: none"> <li>· Adoption of basic EU rules within 3 years</li> <li>· State aids temporarily accepted for development purposes</li> </ul>	<ul style="list-style-type: none"> <li>· Adoption of basic EU rules within 2 years</li> <li>· State aids temporarily accepted for development purposes, except for textiles</li> </ul>	<ul style="list-style-type: none"> <li>· Adoption of basic EU rules within 5 years</li> <li>· State aids temporarily accepted for development purposes</li> </ul>
Standards	<ul style="list-style-type: none"> <li>· Cooperation implemented</li> <li>· EU to assess conformity of products</li> <li>· Mutual recognition sought</li> </ul>	<ul style="list-style-type: none"> <li>· General commitment to cooperation</li> <li>· EU to assess conformity of products</li> </ul>	<ul style="list-style-type: none"> <li>· Cooperation agreements to be concluded</li> <li>· EU to assess conformity of products</li> <li>· Eventual mutual recognition</li> </ul>
Public procurement	<ul style="list-style-type: none"> <li>· Mutual access (with 10 years transition for CEECs)</li> </ul>	<ul style="list-style-type: none"> <li>· No agreement</li> </ul>	<ul style="list-style-type: none"> <li>· No agreement</li> </ul>

*Source: based on Winters (1996) and other sources. Note that the detailed content of the bilateral EU-CEEC and EU-Med agreements may vary from one country to another.*