Central and Eastern European Countries in the EU: Labour Market Impacts of Enlargement?

by

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Summary

Implications for labour markets are integral for any political economic evaluation of EU Eastern enlargement. The resulting new level of unemployment and wages will have direct impacts on social welfare in the integrated countries as well as in the states of the EU. Beyond that, employment and wages are substantial factors of political stability in the Central and Eastern European countries (CEEC).

Starting from a deeper analysis of the initial position of labour markets, the implications of the entry of the CEECs are derived for CEE labour markets. Special attention is paid to the (important) role of the adoption of the EU labour market institutions for the development of the employment policies and the labour market performance in the CEECs. We see substantial dangers for the labour market performance in the CEECs raised by the inevitable adoption of inefficient EU regulations of social and labour policy via the aquis communautaire. However, concerning the emergence of additional asymmetric shocks induced by EU entry as such we are more optimistic.

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1 Introduction

Implications for labour markets are central with respect to any political economic evaluation of EU Eastern enlargement. The resulting new levels of unemployment and wages will have direct effects on social welfare in the integrated countries as well as in the states of the EU (whose order of magnitude, however, will be the subject of a more thorough discussion in this paper). Beyond that, employment and wages are substantial factors of political stability in the central and eastern European countries (CEEC).

The decision in favour of the Eastern enlargement of the EU is probably partly motivated by the aim of exporting stability and prosperity to the newly market-orientated countries. The latter are expected to lead to some positive repercussion effects on the original EU member states in political terms. Included in this motivation is the fear of massive migration from eastern to western Europe (and this is an important point for our topic) if the transition period takes a too long time span. Moreover, there are of course economic interests on both sides as well. The economic relations between the East and the West were really on a poor level and far under their potential due to the special political circumstances. Concluding from this, one is probably on the safe side if stating that the Eastern enlargement has a distinctive polit-economic character.

The doubts by the European Union states consist predominantly of the fact that the immigration or commuting workers could increase the labour supply in the EU significantly, above all in the building and carrying trade sectors in neighbouring Germany as well as in Austria (and with some limitations also in Sweden). The main conjecture by some EU member countries is that companies of the CEECs will possibly use cheap workers, in order to undercut the higher labour costs of the enterprises in the EU. This may possibly not only put the general wage level in the EU under pressure, but also initiate a need for adjusting the systems of social protection towards a more market oriented system. Beyond that, several European Union industries in the 'sensitive' sectors characterised above have already come under an increasingly fierce competition pressure by more cheaply producing providers of the entry countries. Finally, a ‘dislocation’ of domestic industries into the CEECs into the direction of the 'cheaper' workers is feared as well.

However, as this paper will stress, for the CEE candidate countries the principal interest concerning the labour market effects should not so much be to achieve the possibility of full mobility of their labour force. Instead, there are on the one hand raising concerns with respect to the political costs in terms of potential employment losses of the fulfilment of that area of the acquis communautaire which concerns capacities of labour market adjustment to shocks. On the other hand, the candidate countries fear to become 'low wage dumping grounds' with 'bad' conditions of work within an enlarged Europe. Letter could lead to a mutual interest in higher undifferentiated wages which is the institutional escrow issue for the analysis of labour market impacts of the Eastern enlargement. The reason is that the extent in which labour becomes more efficient and more productive by the EU entry will be a core factor for whether the CEEC will internalise trade profits from an entry and can transform them into a better employment outlook for themselves.

Starting from a deeper analysis of the initial position of labour markets, the implications of the entry of the CEECs are derived *for CEE labour markets*. For this purpose, the present situation of the labour markets is examined for the consequences of the transformation process based on usual indicators (chap. 2.1). The return of the CEECs to Europe and the selection of the labour market and wage policy institutions resulting from this are brought up for discussion in chap. 2.2.

Implications of enlargement for the EU labour markets are derived by Belke, Hebler (2000) and are estimated as rather low. Their rather balanced forecast heavily depends on an analysis of the size of enlargement (Gros (2000)). It is often argued that this coming enlargement is unprecedented in terms of the increase in population and other measures. However, this is not the case if one considers the size of the countries that joined during previous enlargements, relative to the size of the EC they joined:

Table 1: Size of the next enlargement comparing with the previous ones

	Population	GDP	Trade
UK+DK+IRL as percent of EC-6	33.5	27.9	13.1
E+P as percent of EC-10	17.5	8.3	4.7
CEEC-10 as percent of EU-15	28.0	4.1	10.9

Source: Own calculations by Gros (2000) of EU and EBRD data

This enlargement is thus significant in terms of population because all 10 Central and Eastern European candidate countries (CEEC-10) would increase the population of the EU by over one quarter (the increase is equivalent to the increase in the German population due to unification). However, by most economic measures the candidate countries are negligible, even if one assumes that their economies will grow rapidly. Table 13 in Gros (2000) shows that in terms of GDP, evaluated at current exchange rates, the 10 accession countries combined would be about 1/15th (7 percent) of the euro area. This corresponds roughly to the weight of Netherlands alone. Most of this, more than two thirds is accounted for by the first wave.[1]

In the following, special attention is paid to the (important) role of the due take-over of the EU labour market institutions for the future development and design of labour market policies and the labour market performance in the CEECs (chap. 3.1). Beyond that, we examine the past development of foreign trade integration (chap. 3.2.1) and foreign direct investment integration (chap. 3.2.2), in order to be able to measure to what extent additional trade and investment effects (and as a consequence of both, additional labour market impacts) of the EU-

[1] In terms of monetary indicators the story is not much different. Given that the candidate countries have rather small financial sectors their combined monetary supply amounts to generally less than 7 percent of the corresponding euro area aggregate. This implies immediately that even serious problems with the banking sectors in the CEEC-10 could never materially affect monetary conditions in Euroland. Moreover, in the financial area most of the weight within the CEEC-10 is accounted for by the relatively more advanced first wave of applicants. In summary, monetary policy induced labour market problems in the EU caused by Eastern enlargement are far from being a realistic scenario.

entry will materialise at the time of EU-entry. In chap. 3.2.3 the future relevance of asymmetric shocks in the CEECs with respect to labour markets is discussed briefly. Our conclusions are presented in chapter 4.

The purpose of this paper is to discuss the implications of enlargement for the CEECs. No complete treatment of this issue is attempted, as it is impossible to do justice to the manifold aspects that would have to be discussed. We concentrate on those issues that impinge on one policy choice that have to be made by the CEECs, namely the take-over of the acquis communautaire.

2 Status-quo of labour markets in the candidate countries

Any forecast presupposes a description of the status quo and an interpretation of the driving forces of past developments. For this reason, the performance of important macroeconomic indicators since 1989 is summarised briefly in this section. We select variables which are relevant for the labour market stance. We focus mainly on Poland, the Czech Republic and Hungary. The labour market developments in the latter countries are emphasized because they until recently belonged (joint with Slovenia, Estonia (and Cyprus)) to the first wave of accession candidates.[2] Since especially these three countries have applied the most urgently for their accession to the EU it is often maintained that the (in the last years) increasingly better macro performance is in part due to the perspective of an EU-membership (Baldwin, François, Portes (1997), pp. 169 f.).[3] Moreover, their experiences might be very helpful in further accession negotiations with less developed transformation economies.

An important assumption underlying this paper is that accession of the more advanced candidates will take place fairly rapidly, for example between 2003 and 2005. Most of the second wave should be able to follow a couple of years later. It is not useful to dwell at length on the precise date. But this assumption implies that by 2010 most of the present candidates will have had already a number of years to adjust and converge within the EU, possibly even within EMU as argued, e.g., by Gros (2000). Moreover, it is useful to recall that most candidates will have to eliminate the low remaining border protection against EU imports over the next years, so that their industries will at any rate have to compete in an open market with EU enterprises. All this implies that most of the adjustment in industry will have to come before accession (see section 3.2). This should be compared to the case of Spain, which was given seven years to gradually eliminate rather higher tariff barriers and was then granted several years of exemption from many single market directives. Spain thus had to undergo the adjustment while inside the EU (a different EU, then called EC).

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2 Second wave is Bulgaria, Romania, Latvia, Lithuania and Slovakia. This distinction is no longer formally correct in the sense that all candidates are formally at the same stage of their accession negotiations. However, in reality the (formerly) first wave countries are in general much further advanced in the negotiations. This does not imply, however, necessarily that actual accession will be in two waves. At present it seems that the first group to enter the EU might be as large as 7-8, with only Bulgaria and Romania as clear laggards (Gros (2000)). However, as this is not certain and the latter two constitute about two thirds of the ‘second wave’ the distinction between *two waves* is maintained for expositional purposes.

3 Following this point of view, a delay or even a failure of enlargement would have negative labour market impacts for the CEECs ('no enlargement and its own costs').

2.1. Macro performance since 1989

It is well-known that the CEECs had to undergo – especially concerning their labour market performance (with the notable exception of the Czech Republic) - *significant adjustment burdens* during their transition to decentralised and market-based economies. Liberalisation of prices lead to a *serious price shock*. However, even more important for the initial development of employment figures in the CEECs was the significant and grave *shock to the output* (Jovanovic (1999), p. 493). In the first two or three years of transition, output fell dramatically in the CEECs. The losses increased to amounts from around 15 percent (Czech Republic) up to 37 percent (Bulgaria) of GDP (Fischer, Sahay (2000), p. 34). Official unemployment rate figures increased within less than three years to two-digit values. They thus exceeded partly even the ‚slowly accumulated' high unemployment rate realisations in continental Western Europe. The painfulness of the adjustment process expressed itself above all by a *severe reallocation of resources*.

2.1.1 Structural change and economic growth[4]

The employment *structure* in the CEEC economies has *changed* substantially during the course of transition. De-industrialisation and de-agrarisation as well as the erection of the services sector are clearly identifiable trends which are, however, dependent on the respective initial situation and path of transformation and thus of different intensity. The planned economy distortions in favour of industrial employment have been abolished nearly everywhere. Nearly all CEECs were hit by a dramatically *decrease of industrial employment*. Seen on the whole, this sector is characterised by a labour shedding of about 3 Mio. employed people during the recent years (Conquest (1999), pp. 4, EU commission (1999), p 9, Wisniewski (1999)). Merely Hungary where services played a more important role already at the beginning of transformation experienced a rather moderate decrease in employment. Seen over the whole sample from 1989 to 1997, also the Czech Republic represented an exception, with a share of industrial in total employment of nearly 40 percent (EU Commission (1999), p. 10).

At the same time, adjustment pressures rose in agriculture as well (Tab. 1). Some of the CEECs and above all the Czech Republic, Hungary, Slovenia and Slovakia experienced a significant decrease in agricultural employment. However, the remaining accession candidates as e.g. Poland and Estonia are still characterised by a very large share of employment in agriculture. On the contrary, in some countries like, e.g., Bulgaria and Romania, the reduction of employment in the industrial sector even led to a sharp increase in employment in the agricultural sector in absolute and relative terms (EU Commission (1999), p. 9). As a consequence, the EU Commission does not classify Bulgaria and Romania as functioning market economies in one of its more recent (November 1998) country reports on the applicants (Lippert (1999), p. 44).

4 For the following see Burda (1998), p. 7, Cichy (1995), p. 666, Conquest (1999), p. 5, Franz (1995), Jovanovic (1999), p. 493.

Tab. 2: Employment in the agricultural sector in selected CEECs (in percent of total employment)

Land	1990	1998
Estonia	n.a.	13
Slovenia	n.a.	7
Czech Republic	12	5
Hungary	16	7,5
Poland	26	26
Slovakia	13	8
Bulgaria	18	26
Romania	29	36
Ukraine	19	22
EU-15	n.a.	5

Source: Breuss, Schebeck (1998), p. 742, Conquest (1999), p. 4, n.a.: not available.

Finally, in all CEECs the relative and absolute magnitude of the services sector expanded markedly. The resulting employment impacts can be regarded as significant throughout. However, they are concentrated mainly on urban regions, leaving unemployment in countries such as Poland, Slovakia and Romania still a grave *regional* problem.[5]

Structural change in the CEECs has been accompanied by a marked *recovery* with respect to their overall macroeconomic performance as measured by the usual indicators of real GDP growth and – with some lag – of the unemployment rate as well (Burda (1998), pp. 4 f.). However, over the whole period from 1989 to 1998 employment growth displayed a less dynamic development than GDP-growth (EU Commission (1998), p. 8). In spite of the strong GDP in the last years, the *levels of income* in the accession candidate countries still continue to lag behind the EU average. Even the two in economic terms leading CEECs Slovenia and with some distance also the Czech Republic are characterised by a per-capita GDP which amounts to approximately 60 percent of the EU average.[6] The remaining CEECs are even much 'poorer' (Slovakia: 43 percent, Hungary: 37 percent, Poland: 32 percent, Bulgaria and Romania: around 20 percent). In the case of the Czech Republic and Slovenia, reaching the average EU income level until the year 2015 (under the assumption of an annual growth rate of 2 percent in the EU) necessitates an annual growth rate of 5 percent. In Slovakia, Hungary and Poland this ‘threshold growth' amounts to 7 to 8 percent, in Romania and Bulgaria even more than 10 percent are necessary.

Employment impacts of the EU Eastern enlargement are often derived on the basis of *projections for the future development of foreign trade* (as one component of GDP, see section 3.2.1). This is often legitimised by the fact that the majority of the growth of *exports* by the

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[5] E.g. Eastern Slovakia was yet not compensated for the massive reduction in armaments industry. See Conquest (1999), p. 5, and EU Commission (1999), p. 10.

[6] For these figures for 1997 see Richter, Landesmann, Havlik (1998), p. 19. See also Breuss (1998), p. 1. It is comparable to the per capita GDP of Greece and Portugal before their accession to the EU. For more optimistic calculation with the same range see EU-Kommission (1999), p. 8.

CEECs to the EU countries can be classified as competitive gains of market shares. In the wake of the year 1992, during the period of active restructuring, the biggest growth rates of foreign trade were *not* gained in the area of the traditional *labour intensive* industries but in the machinery and construction sector. These industries with obvious comparative advantages are - like the traditional industries - characterised by both an *above average intensity in the use of labour and energy* and a *below average intensity of R&D, human capital and tangible assets*. In all CEECs a continuously large scarcity of human capital in skill intensive industries has to be stated. Some improvements in this respect can be established above all with respect to Hungary and Slovenia, and to a lower extent as well for the Czech Republic and Slovakia.[7] These developments clearly correspond with the mainstream results of the research in the impacts of *foreign direct investment (FDI) on the efficiency and growth* in the manufacturing industries of the CEECs. They underline the importance of the FDI flows for the economic 'catch up' process and the labour market performance of these countries (see section 3.2.2 and Richter, Landesmann, Havlik (1998), p. 21).[8]

2.1.2 Unemployment

The adjustment processes induced by the shock of transformation in the countries under investigation differ significantly from each other. Following the market-oriented reforms of 1990, the official unemployment rates in Poland and Hungary rose from a level of null on two-digit values. In Poland this happened in the third quarter of 1991, in Hungary, this critical level was reached in the third quarter of 1992. In Hungary, a maximum of 13 percent was reached in 1993. In Poland, the unemployment rate was topped by 16,7 percent in1994. Since then unemployment fell continuously in these countries.[9] In Poland the decrease even amounted to considerable 6 percentage points (EU Commission (1999), p. 10). However, the development of the *Czech* unemployment rate represented a significant exception during the whole transition period which was admired even by the OECD countries until the currency crisis at the beginning of 1997 (Lavigne (1998), pp. 50 f.). From the beginning of 1994 until the midst of 1997 the latter oscillated between 2 and 4 percent, in order to increase in 1998 to considerable 6,4 percent. Finally, in the year 1998 besides the Czech also the Hungarian and the Polish unemployment rates were *below the EU average*. This phenomenon might be a first indication of the fact that *differences* between the labour market institutions of the analysed CEECs on the one hand and of the EU economies on the other should *not be regarded as too large* any more. (Burda (1998), pp. 4 f., Conquest (1999), p. 4, EU Commission (1999), p. 11, Huber (1999), p. 4). In fact, the extent of the job destruction in the agricultural and industrial sector should have led one to expect an even higher unemployment rate. Thus, a closer analysis of the trends observed in this section is clearly warranted.

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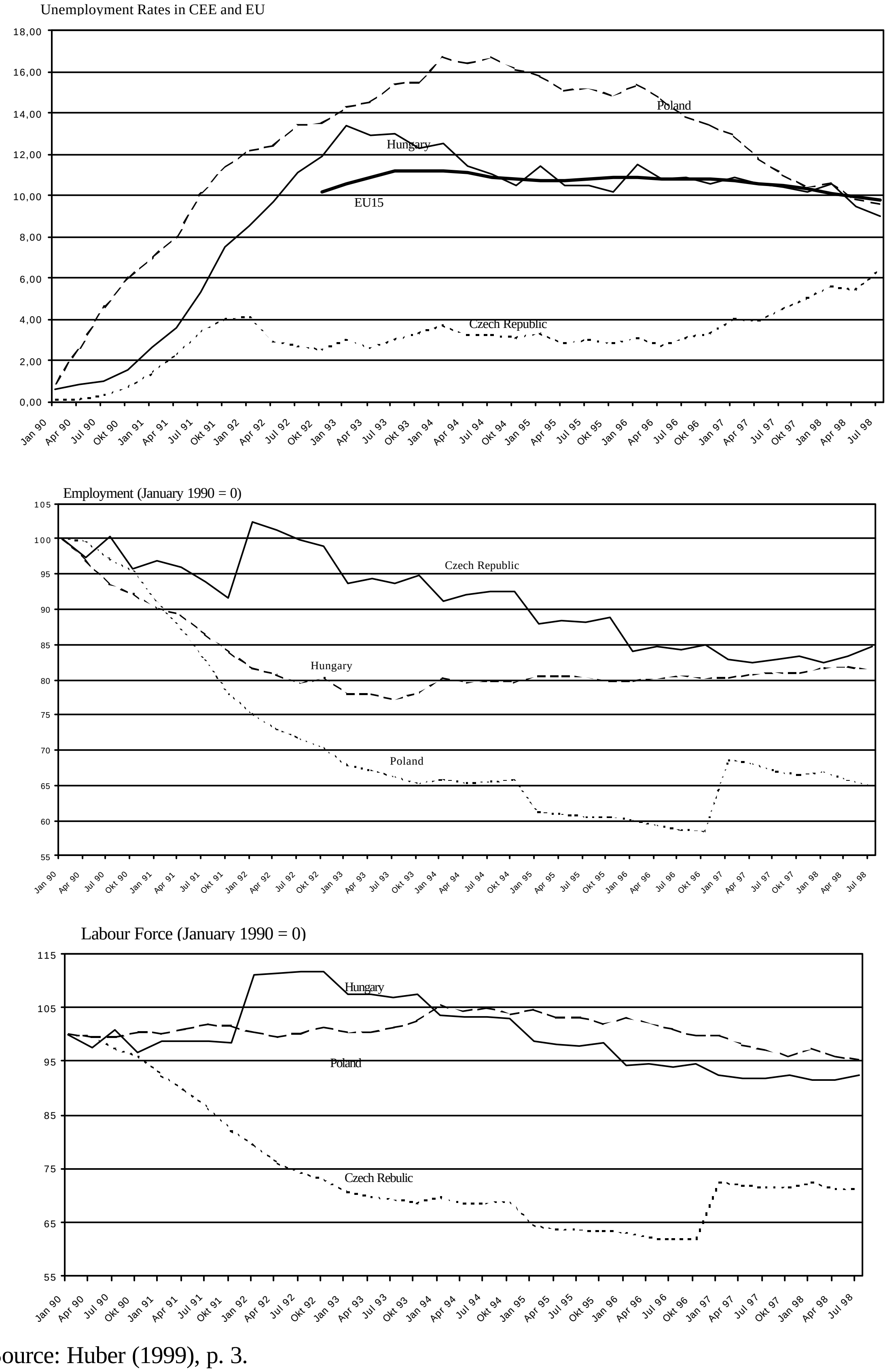
7 See Andersen Consulting (1999), p. 16, Gabrisch, Werner (1998), p. 9, Inotai, Vida (1999), pp. 255 f., and Richter, Landesmann, Havlik (1998), p. 21. Exceptions form this pattern of specialisation are Hungary and Slovenia.

8 FDI inflows are in comparison to other international capital flows less volatile because of their long term character. Because they are an important source of economic and technological know how they have in general positive labour market impacts. See Brenton, Di Mauro, Lücke (1998), p. 2, and Buch (1999), p. 27.

9 In most of the other CEECs the unemployment rates begun to decrease as well in 1993 or 1994. See EU Commission (1999), p. 11.

Fig. 1: Selected indicators of the labour market in Poland, the Czech Republic and Hungary



Source: Huber (1999), p. 3.

The high unemployment rates in the wake of transformation which could be observed in many CEECs can partly be traced back to the *above average participation rate before 1989*.

In the meantime, the participation rates are *comparable* with those observed *in the EU countries* (Burda (1998), p. 6, EU Commission (1999), p. 9).[10] The male participation fell in the recent years below Western European levels. However, female participation stays significantly higher in spite of an initially high reduction. A closer inspection reveals that the developments of labour supply and labour demand underlying these stylised facts are *heterogeneous* (Franz (1995)). In spite of rapid falls in employment, *in the Czech Republic* in the first years following the ‚Wende' low unemployment rates could be registered since the employment potential decreased in a similar fashion. Factors contributing to this development were the growing statistically not registered employment in small private enterprises, the increasing flows of commuters to foreign countries and the reduction of participation rates especially by the females (Walterskirchen (1998), p. 536). Especially in the Czech Republic (and to a certain extent in Slovakia as well) many employees are still hoarded in less productive enterprises. The official unemployment figures do in fact not mirror this hoarding. This could be very misleading because it is exactly this labour hoarding behaviour which will in the medium term (that is, within the next ten years) will lead to a further shedding of a bulk of labour during transformation (Walterskirchen (1998), p. 536). In contrast to the latter, reactions of quantities to transformation were comparably *less significant in Hungary* because of the earlier beginning and the more gradual character of reforms. Both employment and the employment potential decreased by a moderate and relatively constant rate. Finally, *Poland* represents a middle case in the array of CEECs examined herewith respect to the unemployment rate in this country, decreases in employment could not be compensated by a fall in the employment potential (Huber (1999), pp. 3 f.).

The share of the *long-term unemployed* in the total number of unemployed persons amounts to a maximum of 57 percent in Slovenia and Bulgaria and a minimum of 12 respectively 27 percent in Lithuania and the Czech Republic. In the majority of CEECs the labour market dynamics turns out to be relatively weak; the probability of getting again unemployed after a period of being employed is much larger than the probability of getting employed after being unemployed. The long-term unemployed in the CEECs, i.e., the potential migrants for economic reasons, are characterised by a high share of the less educated and qualified (EU Commission (1999), p. 12).

The heterogeneity of individual development paths since the beginning of transformation can be regarded as the *result of different country-specific reform strategies*. In those countries with a relatively high degree of fixed capital investment labour productivity and aggregated output have increased (although, at the same time, unemployment grew). For Poland and Hungary for example a significant improvement of their economic performance could be recorded. However, another country of this group, namely the Czech Republic, was to a certain extent limited by its inability to tackle the problems of companies suffering losses and the financing of these losses by state banks. In contrast, those CEECs which – like Bulgaria and Romania - have up to now nothing to show but rudimentary reforms and have neglected the privatisation of large state conglomerates come off more badly by far. While Poland and Hungary speeded up very actively the privatisation of state companies Bulgaria and Romania

[10] Hungary corresponds to the EU average.

feared the consequences of a shock therapy and preferred a strategy of 'gradualism' (Conquest (1999), p. 5).

Seen on the whole, the interpretation of the stylised facts presented in this section seems to support the interpretation that the most extreme turbulences on labour markets were over in the year 1993. Consequently, an analysis of the 'usual' labour market adjustments and the role of institutions for these adjustments should strictly speaking not start earlier than in the year 1993 when active restructuring actually started (Richter, Landesmann, Havlik (1998), p. 21, Huber (1999), p. 4). Therefore the sample period of quantitative measures of the labour market impacts of the 'return to Europe' is very short (see chap. 3.1.3.1., 3.2.1., 3.2.2.)

2.1.3 Migration and real wages

East-west migration up to now has taken place *within the narrow bands* of bilateral provisions which have been agreed upon in the association conventions between the EU and the CEECs. From Poland which in fact can be regarded as the CEEC with the largest migration potential more than 70 percent of migrants moved to Germany. As measured by 276.753 inhabitants in 1996 (in relation to 81.8 million Germans), Poland (with significant distance followed by the former Czechoslovakia) represents the largest share of the *foreign resident population* with CEEC origin in Germany (Brücker, Franzmeyer (1997), pp. 90 ff., Hönekopp, Werner (1999), p. 5).

Tab. 3: Population from the CEECs in EU member states 1996

	BE	DE	DK*	ES	FI	GR	IT	NL	PO*	SE	UK
Estonia	n.a.	2509	129	11	8446	22	55	n.a.	1	938	n.a.
former Czechoslovakia [1)]	706	59112	418	265	149	1013	3227	555	81	1448	5000
Poland	5371	276753	5216	1946	716	4875	12812	5910	186	15988	27000
Slovenia	n.a.	17328	12	37	6	20	1326	n.a.	3	418	n.a.
Hungary	895	55706	332	221	419	551	2153	1133	84	3046	2000
6 accession countries	6972	411408	6107	3480	9736	6481	19573	7598	355	21838	34000
Bulgaria	635	38847	270	931	309	5241	2882	550	269	1874	2000
Latvia	n.a.	4624	156	25	98	33	107	n.a.	n.a.	282	n.a.
Lithuania	n.a.	4800	161	30	83	71	127	n.a.	3	227	n.a.
Romania	1964	109256	1126	1208	374	5132	11801	1466	99	4186	3000
10 accession countries	9571	568935	7820	5674	10600	16958	34490	9614	726	28407	39000
Share in total population	0.09	0.70	0.15	0.01	0.21	0.16	0.06	0.06	0.01	0.32	0.07
Total population (in millions)	10.1	81.8	5.2	39.2	5.1	10.5	57.3	15.5	9.9	8.8	58.7

* 1995
[1)] Czech Republic and Slovakia (cannot be delivered separately for historical reasons); n.a.: not available.
Source: Hönekopp, Werner (1999), p. 5

The number of the legal employer-employee relationships clearly develops proportionally to the share of the resident population. Therefore, at least in Germany the previous migrants are not hurt by unusually high unemployment or are forced into the black economy to an above average degree.[11] Some 150.000 seasonal workers have to be added whose stay is however limited to a few months by definition (Brücker, Franzmeyer (1997), p. 90).

The future development of migration – especially if the freedom to move will be granted after accession from the start - depends to a large extent on the difference between the real wage levels (and their growth rates) in the accession countries and the former EU countries.[12]

All CEECs started their transformation in the post-communist era with *strong devaluations of their currencies*. This led to a very low level of real wages. In many cases monthly earnings were below 100 Ecu (Portugal's minimum wage at that time has settled at values slightly above 200 Ecu). The cost of one hour of work delivered by a worker in the industrial sector 1994 in Hungary amounted to only 10.5 percent, in the Czech republic to 7 percent and in Romania to merely 3 percent of the German level (Cichy (1995), p. 663). Today, the monthly salaries in the economically most advanced group within the CEECs (Estonia, Czech Republic, Poland, Slovakia) have strongly recovered. They approximately correspond with the Portuguese minimum wage. However, they still fall below the Portuguese average wages still by far. Only Slovenia shows higher wages than Portugal already today. The average wages in Bulgaria and Romania - economies of the ‚second wave' with relatively large populations still fall far below even the Portuguese minimum wages.

Comparisons of wage labour costs between the CEECs and the EU are still quite difficult to enact since at least up to now huge differences with respect to data availability (minimum wages, average wages for a specific sector or total economy wages) exist. In any case, it should have become quite obvious that real wages in Poland, in the Baltic states, in the Czech Republic and in Slovakia *have risen steeply* (by up to 10 to 20 percent) during the time span 1995 to 1997. These trends are extrapolated by Emerson, Gros (1998). Following their forecast, Polish wages will reach the Portuguese level approximately in the year 2005. Later on, growth will dampen somewhat and real wages in the CEECs will converge asymptotically to their new equilibrium values.

[11] In contrast, Brücker, Franzmeyer (1997), p. 90, rate the number of legal employer-employee relationships as low. We cannot follow this interpretation because from the figures of Brücker, Franzmeyer a quota of approximately 40 percent can be calculated which is nearly the same as for the share of employed people of the resident population in Germany as a whole (41.5 percent 1998, see IW (1999), Table 2).

[12] For the following considerations see Emerson, Gros (1998), p. 29 f.

Tab. 4: Wage dynamics in the Czech Republic, Hungary, Poland and Portugal (in Ecu)

	Czech Republic	Hungary	Poland	Portugal minimum	Portugal average
1992	127	218	164	222	536
1993	170	252	184	237	569
1994	201	267	195	246	604
1995	235	237	218	260	644
1996	281	242	255	273	680
1997	294	274	311	286	710
1998	332	296	358	300	745
1999	375	320	411	315	783
2000	424	345	473	331	822
2001	479	373	544	348	863
2002	542	403	626	365	906
2003	612	435	719	383	951
2004	692	470	827	402	999
2005	782	507	951	422	1049

Note: annual growth rates between 1997 and 2005: Poland: 15 percent, Czech Republic: 13 percent, Hungary: 8 percent, Portugal average: 6 percent, Portugal minimum: 5 percent.
Source: Emerson, Gros (1998), Annex 20. Monthly average industry wages.

It clearly seems to be too early at this stage for efforts to quantify these equilibrium values more accurately. However, the latter they will most probably exceed the Portuguese wages in the (nearer) future. This may be explained preponderantly by two factors which taken by themselves enhance inward FDI flows and productivity: geographical proximity to the high wage economy Germany and the relatively high level of education of the potentially employed. This is especially valid for sectors in which technology and working methods have been completely overhauled and a high general education level was available. In fact, the latter is higher in the ‚first wave' of the CEEC accession candidates than in Portugal. In view of their still low per capita income levels the CEECs as emerging markets promise high growth potentials. Apparently, the CEECs strive for an as fast as possible catching-up to the highly developed EU economies (Breuss, Schebeck (1998), p. 749). In summary, the growth of real wage labour costs (in Ecu) is currently much larger than in Portugal. Since at the same time Portugal’s trends in wage development seems to have stabilised relative to Euroland real wage costs in the CEECs converge to the EU average level as well (Emerson, Gros (1998), pp. 29 f., Walterskirchen (1998), p. 537).

With respect to the attractiveness of the CEECs for inward FDI flows and the competitiveness in the EU common market the performance of *unit* labour costs represents a decisive factor. Although the average labour productivity in the CEECs is at the same time much lower than in the EU, the (wage related) *unit labour costs* in the CEECs continue to amount to only a *fraction of the latter in the EU*. Estimations for 1997 take values between 17 percent of the Austrian level in Bulgaria, 25 percent in Romania, 27 percent in Slovakia, 31 percent in the Czech Republic, 37 percent in Hungary, 45 percent in Poland and 72 percent in Slovenia. If one includes *non-wage labour costs* the difference even becomes *more pronounced* (Richter, Landesmann, Havlik (1998), p. 20). However, as already noted with respect to the absolute wage cost differentials, the international competitiveness of the CEECs as measured by unit labour costs has stepwise worsened. This is especially valid for the Czech Republic and Hungary (however, the latter only until 1995) where wage growth has by far exceed productivity growth. These country-specific developments mirror inter alia a different progress in restructuring, country-specific institutional factors (privatisation) and above all (lacking) different degrees of *activities of foreign investors*. The cost advantages of EU companies with FDI activities in the CEECs are comparatively larger since they pay only marginally higher wages than on average in the CEECs but profit from high EU productivity. Moreover, they absorb the ‘cheap’ labour force and thus lower the incentives for a significant migration from the East to the West (Cichy (1995), p. 664, Lankes (1999), Lavigne (1998), p. 51).[13] Finally, an essentially *more compressed wage structure* than in the EU prevails in the CEECs (Layard et al. (1992), p. 37). This is important for the further analysis.

2.2. Institutions of labour markets and labour market policy

During the eleven years since the start of the market oriented reforms in the CEECs, the *assessment* by economists of the functioning of labour markets in these countries has *changed quite strongly*. In the early phase of transformation, a rather *pessimistic* view was dominant, i.e., that on the one hand inflexibilities were necessarily induced by a population which -as an initial condition- was not familiar with the functioning of a 'capitalist' labour market and an inadequate institutional framework. On the other hand, the latter caused high and persistent unemployment in view of the enormous necessities of adjustment during transformation. While this interpretation that labour markets in transformation economies are characterised by substantial rigidities is mainly shared by academic analysis (see, e.g., Boeri / Burda / Köllö (1998)), Layard / Richter (1995) recently rated the *Russian* labour market as *flexible*. Moreover, Burda (1998) implicitly assumes that the labour markets in the CEECs are more flexible than their counterparts in the continental EU, when warning not to hamper the functioning of the flexible CEEC economies by forcing on them the relatively inflexible institutional set up of the EU countries at the time of EU entry.

In view of the ambiguous situation at the outset with respect to this question, this chapter analyses in more depth to what extent labour markets in the CEECs *are in fact flexible in reality*. For this purpose, we give an overview of the evidence on micro- and macroeconomic labour market flexibility in these countries as worked out in the literature so far. Relevant criteria are the incentive effects of the social security systems, the flexibility of the dismissal protection, the organisation of active labour market policies and the degree of regional mobility of the labour force.

[13] Typically enough, the transportation sector was the only branch in the Czech Republic, in which unit labour costs decreased in 1996 because of *Skoda-Volkswagen*. See Andersen Consulting (1999), p. 28.

2.2.1 Wage compensation schemes

Up to now, the focus of the literature on institutional barriers for labour market flexibility in transformation economies mainly concentrated on the *incentive effects* created by the systems of social security. On the one hand, the specific kind and organisation of wage compensation schemes is decisive for the magnitude of incentives to search for a new job (the so called search incentives). On the other hand, the importance of *non-wage labour costs* was emphasised which possibly conflict with the process of creating new jobs. In this respect it is often stressed that the magnitude of the non-wage labour costs depends on the design of the systems of social security.

During transformation, political demand for social security raised quickly since individuals were confronted – as shown in section 2.1 – by hardship of adjustment. For this reason, programs of unemployment benefits, early retirement, of social security income support and severance pay were quickly put on the agenda in most of the CEECs after governments had committed themselves to market transformation. This happened *before* the consequences of these decisions became obvious and in most of the cases *without* an evaluation of the costs which will be connected with it in the future (Burda (1998), p. 9).

According to recent calculations by the EU Commission for 1998 the systems of social security most probably leads to negative employment impacts in Slovakia, in Poland, Hungary and above all in Slovenia (in contrast to the Baltic countries). This conclusion is reached by a comparison of registered unemployment and the unemployment figures according to the labour force survey ('Arbeitskräfteerhebung').[14] Realisations larger than one might signal a) that many registered unemployed have stopped searching, are engaged in the black economy or (even more important for the analysis in this paper) that a protracted registration is a precondition for receiving other additional transfers from the state (unemployment benefits, housing subsidies and health insurance). In those countries where the rate of registered unemployed exceeds the rate which is calculated based on the labour force survey, the preconditions for these claims are probably interpreted rather *generously*. However, this clearly represents an incentive to register oneself as unemployed[15] with implications for total employment as derived above. A more active search of the unemployed and more restrictive preconditions for transfer claims non-wage labour costs would decrease.

[14] For differences with the officially registered number of unemployed see EU Commission (1999), p. 15.
[15] For this interpretation see EU Commission (1999), p. 11.

Tab. 5: Comparison of registered unemployment and unemployment according to the labour force survey (ratio: the former divided by the latter)

Land	1997	1998
Bulgaria	1.0	0.8
Czech Republic	1.1	1.2
Estonia	0.4	0.5
Hungary	1.3	1.3
Latvia	0.5	0.5
Lithuania	0.5	0.6
Poland	0.9	1.0
Romania	1.2	1.4
Slovakia	1.2	1.4
Slovenia	1.8	1.6

Source: EU Commission (1999), p. 15.

However, additional other institutional barriers against more labour market flexibility in the CEECs can be identified, which do resemble those at work until recently in the continental EU economies (Huber (1999), pp. 6 ff.). *Wage compensation payments*, which at the beginning of transformation were granted very generously, were quickly diminished when the unemployment rates increased and the financing of existing claims became increasingly difficult. Insofar, *parallels to continental Europe* become obvious again. In the literature, there is still no consensus with respect to the incentive effects of unemployment benefits in transformation economies. Micklewright, Nagy (1997) for example find that unemployment in Hungary behaved relatively unelastically with respect to changes in the entitlements. However, Wolf (1997) for Hungary and Puhani (1996) for Poland reach the conclusion that the duration of unemployment is affected significantly positively by higher unemployment benefit transfers. *Social security* transfers represent a further important impact on the search intensity of the unemployed. According to Micklewright, Nagy (1999), in Hungary stop of unemployment insurance benefit transfers after a certain time and their substitution by the (on average lower in absolute terms) social security income support *like in many continental European countries* does not lead to an increase of exit probabilities from the unemployment pool.

2.2.2 Non-wage labour costs

The importance of non-wage labour costs has steadily increased throughout the transformation period. Whereas in (continental) Western Europe *legal* regulations represent a large part of these costs, non-wage labour costs in the CEECs tend to take the function of fringe benefits which are *agreed upon voluntarily* in order to attract a high-qualified and well-motivated personnel.

A speciality of the CEECs as compared with the EU economies is bound to consist of the fact that the state was removed an important share of his sources of revenues by the transformation and the takeover of large parts of the economies by private owners and managers. For polit-economic reasons, this led in a direct way or indirectly via contributions to different social funds to an increase in the taxation of labour (i.e. wages, earned income tax). Since these kind of duties can in principle be collected more easily than the usual value-added or the income tax, the governments of the CEECs have become increasingly dependent on these revenues in the recent past. When the financial burdens of the unemployment insurance and the benefits became pressingly high in the course of transformation very soon and, as a consequence, tax revenues decreased (above all in Hungary and Poland), the taxation of labour as a reaction increased again. As a consequence, the demand for labour decreased further. This finally led to the dynamic instability of the whole system. Since in contrast to investigations for the OECD (Nickell, Bell (1997)) for the CEECs a throughout significant and negative impact of taxation of labour on employee-employer relationships cannot be rejected empirically, employment in these countries often got into the so-called *fiscal trap*, i.e. into an equilibrium with excessive taxation and tax evasion. In this connection, the emergence of a comprehensive *black economy* as an evasive action with respect to the increasing taxation of labour can be regarded as typical of the CEECs (Boeri, Burda, Köllö (1998), pp. 86 ff., Burda (1998), p. 10, Welfens (1998), pp. 10 f.).[16]

2.2.3 Rules of employee’s protection against unlawful dismissal

Building on a more comprehensive research project (Boeri, Burda, Köllö (1998)), Burda (1998) compares institutional labour market conditions in the CEECs and in continental Europe. He draws the unambiguous conclusion that most of the CEECs have adapted labour market regulations of the continental European style (for a first impression see Tab. 6). Especially the rules and regulations of severance pay and employee’s protection against unlawful dismissal follow with some exceptions for small and medium firms the *continental European* pattern. However, they are yet not applied as strictly as in continental Europe. As is shown later on in this paper, especially the *EU-entry of the CEECs* will probably lead to a stricter application or even an aggravation of these regulations of employee’s protection against unlawful dismissal.

[16] Further differences can be established above all with respect to the institutions of wage determination both between the CEECs and the EU economies and within the CEECs as such. See extensively Franz (1995), pp. 33 ff., and Bell, Mickiewicz (1999), pp. 130 ff.

Tab. 6: Rules of employee's protection against unlawful dismissal in the CEECs

Country	Law	Definition of mass redundancy	Required consultation with employee representatives	Advance notice	Statutory severance pay
Bulgaria	Labour Code 1994 (Ch. 16,1)	Total or partial closing down of enterprise or stuff cuts	yes	30 – 90 days	up to 1 month, more if stipulated in collective agreements or labour contracts
Czech Republic	Labour Code 1993	Redundancies resulting from changing firm objective, new technical equipment, increasing work efficiency, other organizational changes	yes	3 months	2 months' wages unless collective agreements state otherwise
Hungary	Labour Code 1992	Dismissals of 25 percent of employees or at least 50 people	yes	30 – 90 days depending on seniority	1 month's pay if job tenure was less then 3 years, up to 6 months' pay if job tenure exceeds 25 years
Poland	Act concerning termination of employment relationships for reasons connected with establishments (1989)	Dismissals of at least 10 percent of the staff in establishments up to 100 workers or at least 100 workers in establishments employing more than 1000 workers	yes	45 days	1 month's pay for seniority up to 10 years, 2 months' pay for seniority of 10 – 20 years, 3 months' pay for seniority >20 years + compulsory allowance for lower income workers in new job, up to 6 months
Romania	Labour Code 1994	Dismissal due to organizational changes, insolvency or reallocation	yes	15 days	at least 3 months' average wages, possibly extended depending on seniority and sector of employment
Slovakia	- Act No. 195/1991, Col. on severance pay after termination of labour contract - Labour Code (Act No.451/1992 Col.) - Act No. 387/1996 on employment	at least 10 employees in a firm with 20 – 99 employees, at least 10 percent of employees in a firm with 100 – 299 employees, at least 30 employees in a firm with > 299 employees	yes	3 months	2 months' wages, possibly extended up to 5 months' wages on the basis of collective agreement or an internal instruction of the employer
Slovenia	Labour Code	Following temporary redundancy of up to 6 months (at reduced pay), no numerical limits	yes	6 months	for employees with at least 2 years' tenure: at least one-half of the wage during the last 3 months, for each year of previous employment

Source: Boeri, Burda, Köllö (1998), pp. 90 f., Burda (1998), annex, p. 6.

It is well-known that a negative employment impact of strict rules of employee's protection against unlawful dismissal cannot be derived inescapably and unambiguously from economic theory. However, there is a common sense that the impacts of such regulations cannot be neglected during the phase of transformation (as a systemic structural change) *for small enterprises and start-ups* (Burda (1998), p. 16, Franz (1995), p. 43, Hopenhayn, Rogerson (1993), Wisniewski (1999)).[17] Since firm start-ups can be regarded as a risky and an often in the end unsuccessful venture, rules of employee's protection against unlawful dismissal impact on these activities like a direct tax. These rules have negative employment impacts since they tend to prevent innovation and structural change by start-ups of firms.

It follows directly that the instalment of rules of employee's protection against unlawful dismissal either tends to move small firms out of business or forces them into the black economy. In both cases, significant negative consequences for tax revenues and tends to aggravate the fiscal trap which has already been described above have to be expected. Moreover, the firms have to bear significantly large fixed costs for a separate division for the organisational handling of these rules. From a labour market policy perspective ('Ordnungspolitik') it would make sense to grant small firms some *exceptions from these rules*. In fact, exactly this happened more or less in the CEECs. Merely large enterprises have to obey these rules; small and foreign enterprises as a stylised fact actually manage to evade these rules in one way or an other (Burda (1998), p. 16).

2.2.4 Active labour market policies

During the transition process, active labour market policies (ALMPs) became an integral part of the labour market policies of the CEECs, as they have been in Western Europe since the first oil price shock in the mid seventies. The aim of 'job intermediation measures', 'labour market training measures' and 'job creation schemes' is to enhance flexibility of workers and therefore reduce long-term unemployment (Boeri, Burda, Köllö (1998), pp. 78 f., Burda (1998), pp. 11 f., Wisniewski (1999)). From a theoretical point of view ALMPs seem to make sense even in times of transformation when the majority of enterprises abolish redundant labour which usually becomes manifest in least productive workers. Being unemployed then indicates a low level of productivity, which perhaps could be increased by ALMPs. In contrast the effectiveness of such measures is seen critically in the empirical literature, especially in view of the fact that the labour markets of Sweden and Finland performed poorly using ALMPs as a reaction to the shocks of the early nineties (representative Calmfors (1994)).[18]

Are these results robust regarding the experiences of the CEECs, especially regarding the 'employment miracle' in the Czech Republic up to 1997? It seems that the answer is 'yes'. ALMPs in the CEECs can be characterized as measures that on the one hand actuate stagnating 'unemployment pools' and on the other hand create inefficiencies manifested above all in displacement effects (Boeri, Burda, Köllö (1998), pp. 78 ff., Burda (1998), p. 14). Latter

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[17] On the one hand, the formation and the abandonment of companies are a precondition for productive activity in a rapidly changing world. On the other hand, both formations and abandonments of companies produce valuable information which was rather scarce transformation economies up to now.

[18] For a conclusion and evaluation of Western European experiences with ALMPs see OECD (1998). For first estimations of the efficiency in the CEECs see Lubyova, van Ours (1997) and O'Leary (1997).

means that ALMPs often displace existing jobs instead of creating new ones. Even though the budgets for this policy differ between the CEECs the spectrum covers the same band width as in Western Europe. Several econometrical studies cannot reject the hypothesis that for the Czech Republic the specific conditions in the beginning of the transformation were exceptionally good (the structure of industrial specialization, a well-educated labour force, a large share of services and a small agricultural sector, a tradition for entrepreneurship and the closeness to Germany and Austria) and therefore responsible for the good performance of the labour market, rather than the application of ALMPs (Boeri, Burda (1996), Boeri, Burda, Köllö (1998), pp. 78 ff., Burda, Lubyova (1995)).[19] However, a closer inspection of ALMPs once again supports the thesis that CEEC labour markets resemble EU labour markets in many respects (Huber 1999), p. 7, Wisniewski (1999)).

2.2.5 Regional mobility

Additional to the items referred to above, the development of labour markets in the CEECs can be characterized by the *increase of regional disparities*: „the transformation has a significant regional element" (Burda (1998), p. 7, also Boeri (1998), p. 3, and Wisniewski (1999)). First, there is a strong evidence in favour of the hypothesis that Hungary, Poland and the Czech Republic from 1989 quickly built up regional disparities in unemployment rates. The latter increased until 1993 and since then they have persisted on a high level (Huber, Wörgötter (1999)). Once again, there is a striking similarity to the labour markets of Western Europe (Belke, Gros (1998), Boeri (1998), Bradley, Taylor (1997)). Second, similar regional differences with respect to the development of wages are found (Huber (1999), p. 5). It is generally expected that accession to the EU will strengthen these disparities at least in the short run (Boeri (1998)).

These results underline the extraordinary importance of capital mobility to support regions in overcoming disparities and imbalances as well as compensating an insufficient degree of regional mobility of workers. The latter seem to depend on the dimension of social security systems, regional family circles, infrastructure and a case of 'regional chauvinism' (Boeri, Burda, Köllö (1998), Burda (1998), p. 8). The experiences of Western European economies demonstrate that a reduction of regional disparities regarding to unemployment presume a severe elasticity of wages regarding to differences of productivity as well as an increase in regional mobility of workers. Since the mid eighties some of the EU countries (e.g. Great Britain and Sweden) decentralised wage bargaining as a means to encourage the flexibility of wages. For this reason, the differences in unit labour costs decreased. It seems that this could also be an adequate way for the CEECs to fight regional disparities (Boeri (1998)). As stated above, the CEEC and EU labour markets are resembling in many respects and so do the recommendations to politicians.

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[19] On the other hand it seems that restructuring was slowed down in privatized state enterprises as the EU Commission in their report on the success of the candidates in November 1998 pointed out an alarming deceleration of the speed of reforms (except in Slovenia) especially in the Czech Republic. See Burda (1998), pp. 13 f., EU-Kommission (1999), p. 21, Inotai, Vida (1999), and Lippert (1999), p. 44.

2.2.6 Conclusion

Two important conclusions can be drawn. First, the future dynamics of labour market performance in the CEECs will be different from the EU. This must be considered when the labour market impacts of a further adaptation of institutions are examined. First, the transformation recession determined by some special factors like the collapse of former Soviet Union connected with fiscal and payment balance problems, wars in the Gulf and above all in the Balkans region still impede the recovery of labour demand (problems of hysteresis). Second, job elimination and job creation in the CEECs are connected by endogenous feedback because of fiscal policy (see the discussion of the 'fiscal trap' in chap. 2.2.2). Structural changes as they will be necessary to compete on the Single Market force bankruptcy. However, a too great speed of job elimination will aggravate the 'fiscal trap'. There clearly is an optimal speed of job elimination regarding to job creation on the one hand and the needs of structural change the other hand. Third, our analysis of labour market institutions has shown that the existing new institutions of social security and labour market policy and the resulting incentives will have an important impact on labour demand in the CEECs (Burda (1999), p. 2, Boeri, Burda, Köllö (1998), p. 5).

Second, our analysis reveals that the institutional set up of labour markets at least in the Czech Republic, Poland and Hungary is more of the continental European than of the Anglo-American style. The ongoing crisis of CEEC labour markets can mainly be explained by determinants which are also responsible for the recovering of labour demand after cyclical recessions in the EU. Institutionally caused persistence of shocks have become an integral item in the analysis of labour market dynamics in most Western European economies (Blanchard, Wolfers (1999)). Because of the adoption of institutions of labour and social policy, this will increasingly be important for the discussion of labour market dynamics in the CEECs (Burda (1999), p. 2, Boeri, Burda, Köllö (1998), p. 5). „Put differently, hysteresis effects are gaining importance in CEE countries" (Franz (1995), p. 43).[20] Moreover, the mobility of workers is lower than in Western Europe. Empirical analysis show that the macroeconomic adjustment on labour market is similar to Western Europe. The burden of adjustment is mainly borne by the decision of participation (chap. 2.1.2).[21] Like in Western Europe (Bode, Zwing (1999)), the flexibility of wages so far cannot play a prominent role in adjustment processes (Huber (1999), pp. 12 ff.). The level of unemployment as well as the pattern of regional disparities are similar to the stylised facts of the labour market performance in Western Europe. Overall, one can conclude that the labour markets of the CEECs are predominantly typical Western European (Huber (1999), pp. 14 f.). For this reason, it is unlikely that enlargement will lead to a 'competition of institutions'. Therefore, "Europe as a whole is facing the same challenge" (Franz (1995), p. 43).

What does this results mean for the labour market impacts of Eastern enlargement? In general, the results imply that actually, i.e. before the accession, labour markets of the CEECs are not as flexible as they should be to get full employment in nearer future. Moreover, any ad-

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[20] Franz (1995), pp. 33 f., based on estimations of a Phillips curve, comes to the result that there is robust evidence for a substantial decrease of real wages simultaneous to persisting unemployment.

[21] As in Western Europe. See Decressin, Fatàs (1995).

verse shock for labour markets, e.g. caused by competition of imports, can have persistent effects under this circumstances. If these shocks mainly affect small regions it can result in marked local and extreme persistent unemployment. Eastern enlargement from this point of view implies the same chances and risks for the CEECs as for the EU15. The fast 'return to Europe' of the CEECs constitutes an integration shock for the labour markets of Europe. In a generalised setting, it can be assumed that Western Europe is relative 'rich' in patterns of human capital and capital stock, whereas the CEECs are 'poor' in these respects. Theoretically and based on traditional economic integration theory, one can conclude that in this case the shock will lead to an eastward movement of capital stock and a westward movement of (mainly low qualified) workers. A lack of factor mobility (in the case of non-complete regional specialization) will be partly replaced by international trade (theoretically based by classic international trade theory.[22] This pattern of integration also implies that actually 'cheaper' labour in the CEECs will be 'more expensive' and actually 'expensive' labour in Western Europe will getting 'cheaper'. The wage gap between 'east and west' is determined by capital shortage as well as by a lower efficiency of production, still resulting from former planning economy in the CEECs.[23] The ability of the institutions of labour and goods markets to deal with this fundamental tendencies will be decisive for future development (Belke (1998)). The following analysis shows, that some heavy-weighted aspects of the accession seem to reduce the flexibility of markets and therefore hinder the CEECs from catching up quickly to Western Europe.

3 Employment impacts of EU accession

In the previous chapter, the macroeconomic performance and the choice of labour market institutions of the central and Eastern European accession candidate countries since 1989 were analysed. Interestingly enough, some marked similarities with the continental European labour markets could be established. However, there are some important exceptions from this general rule in the areas of employee's protection against unlawful dismissal and the specific feature of a 'fiscal trap' for employment. In the following, the implications of an ongoing adoption of labour market institutions and policies from the common EU law (‚acquis communautaire') are discussed. Finally, a) a closer inspection of the labour market impacts of foreign trade integration and b) of an increasing degree of foreign direct investment by EU countries in the CEECs and c) a deeper analysis of asymmetric shocks in the CEECs render a forecast of labour market impacts of enlargement possible. However, this forecast still bears not more than the character of a founded speculation.

3.1. Impacts of adopting Western European labour market institutions and policies

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[22] See Straubhaar (1999), p. 4, and Tassinopoulos, Werner (1999), pp. 7 ff.

[23] See Breuss (1998), p. 34, and Layard et al. (1992), p. 56. For capital it will be the other way round. Burda (1999), p. 2, argues, that the wage of an average worker in the Czech Republic, Poland and Hungary from a theoretical point of view, have to be lower than in Western Europe because of a lower capital stock at the same time with higher labour supply. Therefore, given the same technology the capital rent (before integration) is higher.

The majority of labour market institutions of the EU does not have its source in employment policy but in social policy motivations.[24] Accordingly, this chapter primarily focuses on the employment impacts of the adoption of the recently designed EU social policy by the CEECs which becomes necessary by the ‘acquis communautaire’. Just on the 09 December 1989, in Strasbourg a „Community Charter of Fundamental Social Rights of Workers“ was passed. Since the so-called EU Social Charter[25] was voted for only by 11 EU member states without the approval by the United Kingdom, the Social Charter stayed non-binding for a while. However, in the run-up to the signing of the Maastricht Treaty, an ‚Agreement on Social Policy‘ has been passed – again without the United Kingdom – in which the wish has been expressed to implement to the 1989 Social Charter on the basis of the ‚acquis communautaire‘ (preamble). This agreement was ratified and was integrated by the ‚Protocol on Social Policy‘ in the ‚Maastricht Treaty on European Union‘ (EUT) on 07 February 1992. By this unique construction of law (Heise (1998), p. 12) the social policy competencies of the Community were enlarged *without validity for the U.K.* Not earlier than in 1997 the UK declared its willingness to support the common social policy. Since the signing of the ‚Treaty of Amsterdam‘ on 02 October 1997, by which the social policy agreement has been integrated into the ‚Treaty Establishing the European Community‘ (ECT) (art. 136 ff.), all social policy resolutions of the EU are again valid for all EU member states to the same extent (Feldmann (1999), p. 670).

The analysis of employment impacts of Eastern enlargement can be enacted separately in spite of the deep connection between the EU treaty law and the Social Charter. In the following section, it is analysed on a less specific level (treaty law) which implications the new social dimension of the EU can have for labour markets. Subsequently, the consequences of an adoption of the Social Charter and of the derived guidelines and decrees for the CEECs are discussed.

3.1.1 The social policy dimension of the EU

Definitions of the 'social dimension' of the EU inter alia commonly comprise the area of a tax-financed system of benefits to needy people (supplementary benefit as a subsistence level), a contribution- or tax-financed system of social security (pension schemes, unemployment, health and accident insurance) and a legal framework for a corporate constitution giving employees a share in decisions or in corporate controlling. The following statements, however, refer to the most frequently discussed impacts of Social Union in the shape of *legal and wage-contractual restrictions of freedom of action in individual employment contracts* and of a *system of interregional redistribution* to level out different living conditions in Europe (art. 2, EUT, social protocol) (Berthold (1993), p. 415).

The former are especially attractive for EU bureaucrats and also unions since they *do not directly affect finances* and at first glance seem to be able to be passed on enterprises. It is of special importance with respect to the topic of our paper that the social protocol to the Maas-

[24] For active labour market policies see chap. 2.2.4.

[25] The EU Social Charter have to be distinguished from the European Social Charter signed on 18 October 1961 of the members of the European Council.

tricht Treaty provides for the *inclusion of unions and employers' associations* in EU social legislation. It is often argued that the workers and employees organisation yet have no rights for wage bargaining on level of the EU and if they do so the implementation of their results is not sure. This can be refuted with contribution to art. 4 protocol on social policy resp. art. 139 (1) ECT. On the basis of art. 4, 2, social protocol resp. art. 139 (2) ECT they are granted for the first time the possibility to transform their agreements in certain areas, in which the EU have the legislation competence (art. 137 ECT), trough council directives. Thus, national social standards can - assisted by supranational collective pressure groups - quickly become hardly reversible international rules. Under the condition of a resolution of the Council of Ministers these agreements become binding *also for third parties* which are *non-members* of the parties to the contract.[26] A further serious objection might be that the responsibility for organizing wage agreements with respect to working conditions is now implicitly ascribed to the Council of Ministers and the Commission. One possible consequence will be the *standardization of working conditions* in the EU. In view of the already mentioned differing initial conditions in the old EU member countries and in the accession countries, this leads to the danger of permanently high unemployment in the CEECs as well.

It comprises an *increase of the structural funds* (funds for regional development, social funds and others, art. 158 ECT) and the temporary *set-up of a 'cohesion fund'* corresponding to the Maastricht Treaty (support of projects concerned with environmental care and amelioration of infrastructure in EU member states with comparably low per capita incomes, art. 161 ECT).[27] According to the proposals by the EU Commission with respect to the reform of the common agricultural policy (CAP) and the Eastern enlargement of the EU (Agenda 2000), the agricultural sector of the CEEC economies were for the time being denied the future access to the direct compensation payments for cutting supply prices in the EU15 (Breuss, Schebeck (1998), p. 742, Knaster, (1999), p. 12). It has been forcefully argued that there is no justification for compensation payments since the food prices in the CEECs will tend to increase in the wake of their EU accession. However, the accession countries were instead promised a net amount of structural aid (‚Heranführungshilfe‘) of *similar magnitude* in order to support their national agricultural sectors according to their own country-specific criteria (Bell, Mickiewicz (1999), Boone, Maurel (1998), Lippert (1999), pp. 42 ff., Pouliquen (1998), pp. 507 ff.). Of special importance for the following arguments is that the CEECs will be *net receiver countries* respectively cohesion countries. The reasons are the current agricultural and structural policy by the EU, the CEECs’ relatively low per capita GDP (throughout smaller than 75%, the latter being the definition of the so-called target 1-areas) and the CEECs’ high share of agriculture in GDP. The connected fiscal burden of enlargement will meet inter alia also the

[26] This method was first operated in 1996 with the Council Directive 96/34/EC of 3 June 1996 on the framework agreement on parental leave concluded by UNICE, CEEP and the ETUC. See also Feldmann (1999), p. 674. 1997 and 1999 two more directives of the same kind followed. See Council Directive 97/81/EG of 15 December 1997 and Council Directive 1999/70/EG of 28 June 1999.

[27] Structural funds are actually approximately 40 per cent of EU expenditure. See also Baldwin, François, Portes (1997), pp. 150 ff. The Cohesion fund is 3 bill. Euro per year up to 2006.See Breuss, Schebeck (1998), p. 743.

EU countries and their labour markets, although this might happen to a different and country-specific extent.[28]

A policy of social cohesion is officially justified by the promise that *growth prospects* would be the more positive the more *homogenous* the European market were. Moreover, competitive distortions caused by '*social dumping*' (art. 6 GATT) could be excluded by an EU-wide social policy. Proponents of the ‘social dumping hypothesis’ argue that states with a low-degree social safety net gain a comparative advantage by lower labour costs. Through the competition by ‚cheaper’ and more labour-intensive goods or through emigration of capital towards regions with lower social costs (in our context, the CEECs), countries with social safety nets are forced to cut the in order to stay competitive. By this, a de facto downward harmonisation of social standards would emerge. Finally, an *efficient* social policy were possible only at a *supranational* level since factor markets are opened to international competition. All these arguments, however, can be refuted by the reference to the *advantages of a competition of systems* which in view of cartelized goods and factor markets enables the catching up countries to use their specific locational advantages. From this point of view the cost differentials stemming from lower social standards cannot be called 'social dumping' but are founded on *real* grounds like, like e.g. lower non-wage labour costs, which actually are *not ‘unfair’*, as, e.g., resulting from some kind of monopoly power (Belke (1998)).

Therefore, it seems to be more plausible to assume that the poorer EU-countries see their locational advantages vanishing because of EU enlargement and, thus, strive for a *stronger social cohesion*. The poorer countries are *supported* in this respect *by different European institutions* like the Commission. Besides the general and well-known incentive to concentrate new and above all more competencies in Brussels also *other advantages* which result from the transfer of organizational rights concerning social minimum legislation to employers' and employees' associations (Art.139 UCT) induce the Commission to support policies of social cohesion mainly enacted by the wage-negotiating parties. Formally there is no loss of competencies for the Commission anyhow because the Commission continues to own a monopoly of proposals. The transfer of organizational rights concerning social minimum legislation to employers' and employees' associations is primarily of concern for the Commission since it can thus counter the accusation, EU social minimum legislation would offend against free collective bargaining in the member countries. Second, it can thus *increase the costs of a rejection of drafts of resolutions* for member countries The main reason is that these drafts are weighed more heavily by the Council of Ministers if they are based on agreements of the wage-negotiating parties. Third, it corresponds to the *centralization interest* of the Commission to revalue European associations and pressure groups, to render them able to stand trial and to integrate them into corporatistic procedures like a coordination of stabilization and incomes policy. Fourth, sometimes the hypothesis is brought forward that EU institutions

[28] See Breuss (1998), p. 1, Breuss, Schebeck (1998), p. 742, Cichy (1995), p. 665, Kohler (1999) and Weimann (1999), pp. 3 ff. From a broader employment perspective, a non-neglectable precondition of Eastern enlargement of the EU is anyhow that the responsibility for income support in the agricultural sector will be transferred to national institutions. Since income and wage policy represent the business of the member states according to the Maastricht treaty, the same should be valid with respect to the financing of income support. See Seidel (1999).

have an original own interest in the constellation that wage policy and labour relations are handled supra-nationally. The less flexible the latter are, the more convincingly could the EU legitimise to extend their funds and, by this, to maximise its prestige and power (Belke (1998)).

It is not out of place to allege that also *unions* and *employers' associations* are interested in a centralization of social policy in the Maastricht tradition. For the unions central tariff bargaining with legal implications for non-members on the one hand are not desirable in times of full employment because of the danger of mass black riding (‚trittbrettfahren‘) but on the other hand this prevent the union members in times of high unemployment of being replaced by non-unionists who are willing to work for lower wages. Therefore, actually the unions are supposed to have an enormous interest in centralising wage bargaining. *Employers' associations* are governed by incentives to support the unions' efforts in this direction as already demonstrated in the case of German currency union (Sinn (1999), pp. 13 ff.). This offers them the opportunity to get rid of unpleasant competitors from poorer EU-countries by means of harmonising labour costs at a comparatively high level. This can also be interpreted as an attempt to compensate for home-made disadvantages in competitiveness by an export of these disadvantages to other countries. This is especially relevant in the case of large-scale, employment-intensive enterprises which beyond doubts can reckon on public subsidies to cope with an employment crisis.

Moreover, *further arguments* are often put forward *in favour of an interest of wage-negotiating parties to assist in shaping European social legislation*. First, negotiations in this field lower the costs of lobbying and rent-seeking. Second, negotiations protect against the risk of an -from their point of view- unfavourable proposal by the Commission. Third on average the outcomes of such negotiations rather than proposals by the Commission correspond to the associations' preferences. Fourth and most important, negotiations allow solutions which get the wage-negotiating parties certain *advantages at the expense of third uninvolved groups*'. The restrictive number of organisations admitted to take part in the social dialogue by the Commission makes things easier in this respect. Typically, the *interests* of third uninvolved groups like *'outsiders*', unemployed or insecurely employed persons, are *not taken into consideration* in this dialogue. One of the most common examples in this respect is the setting of *too high social standards*. Since 'outsiders' in the end often disappear from the *official* labour market statistics and thus do not influence the reelection prospects of national governments as much as before they are not provided with an influential lobby in the Council of Ministers whose members have to take care of their reelection. These statements even suggest that the Commission might deliberately attempt *to exclude* certain groups, i.e. 'outsiders', from negotiations concerning European social legislation *to encourage* others, i.e. unions and employers' associations, to take part. This probably is one of the basic insights with respect to the following reflections.

In summary, *concrete prospects* of outline agreements at the EU-level concerning 'Europeanizing the social partners' and their application to member countries loom on the horizon. Even if a centralisation of wage policy has not to be expected in the medium term, it appears to be only a question of time according to Olson (1982) for the above mentioned reasons that wage cartels as so-called ‚distribution coalitions' (which at least indirectly act unionwide) begin to exist within an enlarged European union as a changed institutional environment.

At the same time a *deviation from a productivity-oriented wage policy* becomes *optimal* if intra-EU transfers are granted (although inter-state fiscal transfers are not included in the essential trait of the EU, see Steinherr (1999)) and wage-negotiating parties do not have to stand in completely for the emerging costs, like e.g. increasing tax burdens. The loss of social policy as a parameter of an efficient competition of member-countries thus obviously leads to *welfare losses* probably reflected in an increasing unemployment. Moreover, employment efficiency of cohesion policy is severely hampered by empirically well-founded *seeping out- and take away-effects*. These effects might be explained by an imperfect exchange of information compatible with incentives of the involved parties, problems of coordination in the Brussels head office and others. Finally, *economic processes of integration* do *not* seem to be necessarily *supported by social cohesion* from an empirical point of view.

3.1.2 Labour market institutions of the EU Social Charter

In the ECT it is expressly referred to the "fundamental social rights such as those that out in the European Social Charter signed in Turin on 18 October 1961 and in the 1989 Community Charter of Fundamental Social Rights of Workers" (Art. 136 ECT).

The European Social Charter of 1961 is a contract between the members of the Council of Europe, which has been signed by 33 European countries and ratified by 25 so far. An extended version was passed on 3 May 1996 in Strasbourg and meanwhile has been signed by 22 countries and ratified by 5.[29] Since in both contracts a derogation right is expressly intended concerning the acceptance of individual principles and the Council of Europe does not have any serious capabilities of sanctions against its members, an analysis of the total package, as it is done by Boeri, Burda, Köllö[30] (1998, pp. 92 ff.) seems to be hardly meaningful.

The 'Community Charter of Fundamental Social Rights of Workers' – the so-called EU Social Charter – was accepted by the European Council on 9 December 1989 in Strasbourg against Great Britain's vote. It covers twelve paragraphs dealing with questions concerning liberality, occupation and wages, the improvement of living conditions, social protection, freedom of coalition and wage negotiations, vocational education, the equal treatment of men and women, the information, hearing and co-operation of the employees, the health protection and security on the workplace, protection of children and young people, aging humans as well as the handicapped ones. However, the principles of the Social Charter can be implemented by European law only within the areas of the community authority. Within all areas going beyond that, they have to be carried out by national regulations. It is generally expected that the ratification of the Social Charter will be the prerequisite of becoming a new member, since it is explicitly mentioned in art. 136 ECT and thus "integral to is the EU's constitutional acts" (Breuss (1998), p. 2, Lavigne (1998), p. 41).

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[29] All ten EU candidates from Central and Eastern Europe are members of the Council of Europe and have either signed the Social Charter of 1961 (Czech Republic, Hungary, Latvia, Poland), of 1986 (Bulgaria, Estonia, Lithuania) or both (Romania, Slovakia, Slovenia).

[30] Particularly since the authors essentially refer to the version of 1996, which is not mentioned in the ECT. See Boeri, Burda, Köllö (1998), p. 92.

A *well-meaning interpretation* of the Social Charter might be that it represents an expression of Europe's striving for solidarity and of the effort to seize this into a common doctrine. From this view a return of the CEECs to Europe implies a *common and uniform* attitude towards the interpretation of a 'European labour market and social politics'. The Social Charter contains several regulations, which are separately and legalistically seen not yet specific enough to be acutely employment-endangering, but obligate the member countries in their whole to a lower bound for common 'conditions of work' (Belke (1998), pp. 220 ff.) A *less well-meaning* interpretation of the Social Charter, however, accuses it of creating seriously employment-endangering labour market rigidities with simultaneous protection of the employed insiders of the 'rich' EU-countries against the competition by employees from to 'poorer' member countries (Burda (1998), p. 18).

Feldmann's closer analysis (1999) of the European Union directives of 1992 onwards which are based on the Social Charter seems to support rather the less well-meaning interpretation.[31] So far the directives and regulations issued on basis of the Social Charter and the extended authority of the EU are „alles andere als sozial. Sie verschlechtern die Erwerbschancen insbesondere der sozial Schwächeren, etwa der jüngeren Frauen, der Jugendlichen oder der Arbeitnehmer aus den ärmeren EU-Ländern. Darüber hinaus verletzen sie die Präferenzen vieler Arbeitnehmer. Und nicht zuletzt gefährden sie bestehende Arbeitsplätze und behindern die Entstehung neuer." (Feldmann (1999), p. 676). For example, the implementation of the work time directive of 1993 caused substantial costs for the member countries. Thus the legal minimum vacation in Germany amounted before 1993 only three weeks, and not as in the directive prescribed four weeks. In Great Britain approximately 2.5 million humans worked longer than the 48 hours max. designated per week. The implementation of the minimum vacation regulation would have increased labour costs in Great Britain by 0.5 % in 1993. Feldmann (1999, p. 672) concludes that the directive reduce the adjustment flexibility of the labour markets of the EU. As analysed above, especially the CEECs still need greater adjustment capabilities due to the transformation of their economic systems, which even might speed up with the enlargement. As the work time directive other socio-political measures of the EU were to be seen just as critical, in particular the assignment directive of 1996 and the directive on the establishment of a European works council of 1994. The assignment directive, which has been justified by the principle of the right to liberality, prevents exactly this. With their assistance, relatively highly remunerated employees were protected against competition from 'poorer' EU-countries (Feldmann (1999), pp. 671 f.)

The latter seems to suggest a rather *cynical interpretation* of the Social Charter. It seems to be the attempt of some of the so far united EU-countries to export job market rigidities and to prevent wages and social standards from slipping by poorer and 'catching up' economies, which offer a more competitive production environment because of lower labour costs (see

[31] E.g. numerous standards as to the health service and security on the workplace; council directive on maternity protection of 19 October 92; the work time directive of 23 November 93; council directive on youth employment protection of 22 June 94; council directive on the establishment of a European works council of 22 September 94; council directive on the framework agreement on parental leave concluded by UNICE, CEEP and the ETUC on 3 June 96, and the strongly disputed assignment directive of 12 Dcember 96. See Feldmann (1999), pp. 671 ff.

paragraph 2.1.3) and a lower standard of living (Boeri, Burda, Köllö (1998), pp. 92 f.) accepting that unemployment will also be high and lasting in the CEECs. The implementation of the Social Charter obviously is carried out the *more energetically, the nearer* the entry of the Central and Eastern European national economies moves. The EU Commission launched a whole series of suggestions in March 1998 in order to extend the work time directive of 1993 to employees who had been excluded so far. Beyond that different directives expanded vacation, pension and dismissal regulations to some of so far excluded divisions of enterprises (Burda (1998), p. 18).

Due to our analysis of the labour market institutions of the CEECs we can at least partly follow the less well-meaning interpretation. It seems as if a set of labour market institutions has been already developing in the CEEC that is strongly modelled on the continental-European type. This can be interpreted as an effort of these countries to acquire an 'EU profile' in the apron of the negotiations of accession and the entry decision.[32] However, from an employment-political view meaningful exceptions are made (e.g. with the protection against dismissal; see section 2.2.3). Additional other rules that have their origin in the conceptions of the Social Charter have not been implemented resolutely enough with view of the employment situation. Since the CEECs is still able to produce with significantly lower labour costs even with this kind of institutional set up (FAZ (1999c), paragraph 2.1.1), it might be in the interest of present EU-members to implement such measures in the future which prevent a direct wage competition with the entry countries as the cynical interpretation of the EU Social Charter supposed. The resulting increase of labour costs, the emergence of the well-known 'option value of waiting with the employment decision' and the introduction of regulations and standards will strongly reduce the attractiveness of CEEC for FDIs as well as the competitive ability of the CEECs in the Single Market. Therefore, the transfer of EU legislation and EU-'case law' - the *acquis* – will tend to reduce the economic growth of the CEECs and increase the unemployment rates. Since the EU set of rules was conceived *for 'rich' democracies* with extensive systems of social protection, it does not appear to be suitable for an application to 'poorer', but rapidly growing economies.[33] In principle, the CEECs surely need market economy rules for the removal of investment-restraining legal uncertainty. Likewise, the transfer of first set rules such as the acquis (via 'accession partnerships', Bauer (1998), p. 16) is justifiable from the point of view of a *reliable obligation to the transformation process* (against groups representing different politics) (Baldwin, François, Portes (1997), pp. 169 f. and 173, Kohler (1999), p. 2). However, the acquis in any case represents an *unsuitable set of rules* for economies, which are only in the center of their 'takeoff' (Baldwin, François, Portes (1997), p. 128).

3.1.3 Conclusions for the development of employment

A closer inspection of the previous arguments in this paragraph reveals that the latter strongly resemble those arguments that were brought forward during the debate on the *labour*

[32] Similar observations have been made as in other areas such as agriculture, home affairs, justice and regulation. See Boeri, Burda, Köllö (1998), p. 94.

[33] One imagines Korea, Taiwan and Hong Kong in a comparable level of their development would have had to transfer the rules of the Social Charter. See Baldwin, François, Portes (1997), p. 128.

market impacts of German reunification, the latter actually leading to an economic and *social union* between the two German states (Jovanovic (1999), p. 493). If an EU-entry of the CEECs also implies the adoption and implementation of the Social Charter by these countries, it appears justified to speak of labour market impacts of an *extended Social Union* in the context of the Eastern enlargement. The flexibility of labour markets as a market coordination mechanism will probably be limited by introducing a Social Union, if the latter manifests itself in an ex ante harmonisation and a centralisation of social politicy. The significant reduction of limitations on goods and factor markets due to the enlargement is implicitly taken back partially by an extended Social Union. Simultaneously, in a Social Union it is done without the dynamic efficiency gains of an institutional competition on a socio-political area and thus without additional employment potentials.

An extended European Social Union in form of global regulations against dismissal, (indirectly effected) harmonization of minimum wages as well as general commitment assertions of collective wage agreements etc. causes *additional unemployment* in a first step particularly in the CEECs *with by now lower social standards*. At the same time labour costs rise, if jobholders, i.e. the ‘insiders’ on labour markets, do not practice sufficient wage restraint or - as it became already very clear at the German reunification - a high wage policy is falsely forced in the CEECs, in order to avoid mass emigration (Sinn (1999), p. 15, and indirectly Jovanovic (1999), p. 493). The incentive to a wage restraint is rather small because of fiscal activities of the welfare state (which are anticipated by 'insiders') aiming at the avoidance of incentives for emigration from the CEECs ('quasi full employment warranty', public employment or income transfers without work such as unemployment benefits, social welfare assistance and regulations of the early retirement) whose probability rises significantly in an extended EU.

Comparative cost advantages of the new periphery (CEECs) will be eliminated by the behaviour of insiders in those countries with low social standards in expectation of active flow of funds or by a high wage policy (or a bulkheading policy by political-legal standards, Straubhaar (1999)) in order to avoid emigration from the CEECs. As a consequence, a political pressure to *transfer payments* emerges according the experiences with the German reunification. This is the direct result of the very common misperception that a mass emigration can be stopped by too high wages. Among other things in the apron of the CEECs entry, a demand to *regroup the European Union structural funds*, the *cohesion fund* and different ‘community initiatives’ in favour of the ‘poorer’ new EU member countries was raised. However, at the same time it is still *unclear* to what extent the past periphery (Ireland, South Italy, Andalusia, South Portugal and Greece) is ready to do without such means and to operate a ‘subsidization of the poorest ones by the second poorest’.[34] The financial frameworks from the EU for the years 2000 to 2006 hints at an expense reduction of agricultural and structural policy by almost a real quarter, in order to be able to carry the fiscal load due to the extension (Breuss (1998), p. 2, Breuss, Schebeck (1998), p. 742, Lippert (1999), p. 39). Especially the by now most important recipients of transfers from the structure funds, the countries of the EU periphery, cannot be ranked among the main trade partners of the CEECs and thus among the

[34] See Breuss, Schebeck (1998), p. 744: “Hier ist in Zukunft eine Verteilungsdiskussion zwischen den Kohäsionsländern und den ‚reicheren‘ EU-Ländern zu erwarten”.

most important winners from the customs removal and the expansion of the Common Market. If one assumes persistence tendencies of the so far main recipients, even rather a significant *increase* of the funds resulting from motives for compensation instead of a mere regrouping can possibly be feared (Cichy (1995), pp. 664 ff., Jovanovic (1999), p. 493, Kohler (1999)). However, these funds are to a large extent inefficient and tend to increase the costs of Eastern enlargement (Jovanovic (1999), pp. 492 f., Seidel (1999), Steinherr (1999), Weimann (1999)). Means of the structural funds could better be replaced by credits (Steinherr (1999)).

The intention officially obtained with the regrouping of the means is to support the convergence efforts of the countries willing to join. However, if one studies the announcements of different EU organs more intensively, then it becomes quickly clear that the increase of funds is explicitly aimed at employment policy as to reduce the incentives for emigration (e.g. Pouliquen (1998)). Besides, in the context of the existing funds for regional development (EFRE) and the social fund (ESF) the assignment of transfers is connected partly directly or indirectly *with the employment target*. Typically, *'unemployment'* instead of from the efficiency point of view more meaningful *'employability'* is determined as criterion for the allocation of the structure funds in the 'Agenda 2000'-package (Emerson, Gros (1998), pp. 39 ff.). If one gives way to this pressure on the part of the less indebted countries and if financial transfers will therefore be carried out, the tax burden in the old EU countries will continue to rise. Sinn (1999) quantifies the potential costs of the presented policy-mix, i.e. a *high wage policy* connected with the *payment of a 'stay-put premium'*, at the level of over 2600 billion euro per decade. On the one hand, the expressed social costs include the prohibition for dismissed employees to emigrate from the CEECs and to participate in the production process of the 'old' EU members. On the other hand, workplaces are destroyed, whose productivity exceed the productivity of workplaces (reduced by the migration costs) in the 'old' EU countries (Sinn (1999), p. 15).

This enormous financial burden will probably lead to further growth and employment losses in the 'old' EU countries, particularly since the tax burden and also the government expenditure rate have already been clearly increasing by rising tax and social payments since the beginning of the eighties on average in the EU. At the same time, the dependency on transfers – not always assigned in the most efficient form – of the less developed CEECs will grow. As the German reunification and the development of Southern Italy show, restructuring measures, which appear indispensable for a long-term improvement of employment, are then often protracted. Since an extended social union leads to unsatisfactory economic results and a vicious circle transfer-unemployment-transfer-... , *further interventions*, not justified by the market, such as a European industrial policy (art. 130 ECT) can be feared: "the persistent lack of well-functioning markets provide strong arguments in favour of formulating industrial policies to strengthen the competitiveness of manufacturing firms (...). The EU's legal framework leaves room for designing such a policy with subsidies" (Gabrisch, Werner (1998), p. 79). On a long-term basis, such a policy is, however, in the case of negative dynamic incentive effects not positive for employment without restrictions. Under appreciation of the preceding discussion it does not seem advisable regarding to the labour market impacts of Eastern enlargement, if one moved due to a consent ability lacking within other areas a *Social Union* as an expression of political union into the foreground.

3.1.3.1 Quantification of the negative labour market impact

The preceding analysis suggests negative labour market impacts of the accession for the CEECs. Even "quantifying such costs is important, but seemingly impossible" (Baldwin, François, Portes (1997), p. 128), Boeri, Burda, Köllö (1998) still try to test this hypothesis by a *time series analysis procedure*. They examine time series of (structural) unemployment rates and growth of employment for all Western European member states, who joined the EU after 1970. In doing so they accept that the results of their analysis are based on *historical* parameters, to which the current entry situation is a *structural break*. Because the Southern enlargement of the EU was comparable neither in its magnitude nor in its degree of difficulty with Eastern Enlargement (Kramer (1998), p. 720). Based on an introductory 'Burns-Mitchell' analysis (applying the reference cycle method), Boeri, Burda, Köllö (1998) conclude that the examined countries saw themselves suspended already along with their *application* for the EU-entry to the strongest rise of the natural rate of unemployment. This rise continued after the accession particularly in relation to the core countries of the EU.

Based on a pooled cross country time series analysis, they reach - quite similarly to their 'Burns Mitchell' analysis - the result that both the application for the entry and the de facto (later) entry led to a significantly higher unemployment rate in relation to the main member states. Interestingly, the *date of application* proved to be comparatively *more important* than the actual date of accession (Boeri (1998), p. 2, Burda (1999), p. 3).[35] According to the estimates, their application led to a rise of unemployment (relative to the core of France, Italy and Germany) from 14 to 22 per cent. This result impressively demonstrates the important role of expectations for example of the 'social partners', i.e. workers and employees organizations, concerning the EU-accession.[36] These results are robust even against the case without Austria, Sweden and Finland. This underlines the potentially negative impact of integration, since the latter concerns countries, who did not register any upward 'ratchet'-effect as to their unemployment rate during their non-membership in the EU (Burda (1998), p. 21). If one extrapolates the case of Spain to the Polish one, with Poland displaying a similar branch structure of production (a high agricultural share of employment), then a rise of the unemployment rate from 1.5 to 2 per cent can be forecasted on the basis of the obtained results for Poland (with a quota of 10 % in the core) (Burda (1999), p. 4).

According to Boeri, Burda, Köllö (1998), the negative empirical results concerning unemployment can be explained by the fact that an *EU-accession* gives some leeway *for* a structural change and *short term unemployment*. If the necessary adjustment process is delayed by an increasing (for richer national economies conceived) 'continental European' system of social protection, a permanent increase of structural unemployment as a result of the expected

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[35] This result is identical with the result of Richter, Landesmann, Havlik (1998), p. 22: "the accession process (and not the formal accession as such) probably plays a more important role in the (...) European integration".

[36] However, the EU accession is accompanied by a significant rise in employment in certain specifications of the used test equations.

accession cannot be excluded ('hysteresis in unemployment').[37] The experiences of the former dictatorships Spain and Portugal demonstrate that these negative impacts on employment possibly are relevant only in the short run if the integration process is accompanied by an appropriate set of labour market institutions which promotes the sectoral mobility of the labour force and job creation (Boeri (1998), p. 2).

3.1.3.2 Recommendations for economic policy

The integral message of our analysis should be clear without any ambiguity. When deciding on implementing the labour market institutions of the EU, the CEECs have to consider their extraordinary high needs of adjustment capabilities. While the accession to the EU will definitely induce (and – by association procedures - has already induced) significant gains it also will bring with it the additional burden of restructuring the economy. Our institutional economic analysis delivered the result that the necessary process of restructuring itself can be endangered by a too early accession if the latter is accompanied by the need of a strict implementation of the EU labour market institutions. The reason is that in this case costs are implied which are mainly manifested in lost adjustment capabilities of the labour markets of the CEECs. These real costs have to be added to the financial burden of the implementation of the acquis which are more often discussed in the public as cost components of the enlargement (Jovanovic (1999), pp. 489 f.).

From this point of view, it would be a serious mistake to adopt the Continental European labour market rigidities, especially concerning small and medium enterprises as well as the shadow economy, in such an early point of time in the transition process (Baldwin, François, Portes (1997), p. 128, Bell, Mickiewicz (1999), Burda (1998), p. 22). Because the accession will lead to an intensive restructuring connected with increased labour shedding in shrinking and accelerated job creation in growing sectors in the CEECs. Therefore, policies which tend to increase the intra-industrial and regional mobility of workers should play an important role in the wake of accession. As stated above (chap. 2.2.5), a decentralisation of wage bargaining might be one possible kind of such a policy as well as the design of unemployment benefits (chap. 2.2.1, Biffl (1998), p. 1, Boeri (1998), pp. 2 f.)

A strict implementation of the labour market institutions of the EU social charter implies a reduction of international competitiveness and a lost chance to increase the standard of living rather quickly. For this reason, it seems to be the case that the social standards of the EU should be one possible area of derogation in the negotiations of accession. The motivation could be 'no funding available' as high costs of the adoption could be expected (Richter (1998), Richter, Landesmann, Havlik (1998), pp. 8 ff.). Of course a derogation is not in the interest of the EU, because it would finally induce „losses through competition under unequal conditions" (Richter, Landesmann, Havlik (1998), p. 9). But on the other hand, there are requests for derogation from the side of the EU in the areas of migration and agriculture. If the

[37] See also Burda (1999), p. 3. Baldwin, François, Portes (1997), p. 128 mention this aspect in their introduction. However, they do not examine it in a direct manner, but analyze in particular the fiscal and the foreign trade implications of the EU accession.

CEECs agree with this, they would have to take losses in income and employment into account (Richter (1998), Richter, Landesmann, Havlik (1998), p. 9, Inotai, Vida (1999), p. 254).

3.2. Other labour market impacts of enlargement

Baldwin, François, Portes (1997), Richter, Landesmann, Havlik (1998), Wisniewski (1999), and van Aarle, Skuratowicz (2000) analyze costs and benefits of Eastern enlargement for the CEEC especially in the areas of foreign trade, direct investment, and structural change. These studies can be used for a prognosis of the labour market impacts. However, direct extrapolations of future performance of labour markets based on prognoses of foreign trade development (chap. 3.2.1) can be problematic (Belke, Gros (1999)) and should therefore be interpreted with restraints. It is important to notice that dominating CGE ('Computable General Equilibrium') models (Baldwin, François, Portes (1997) and Brown et al. (1997)) use the assumption of full employment. Therefore these models primarily stress the accession induced restructuring of employment in the CEECs. Finally, the CGE models have a generally ahistorical character and implicitly accept the neoclassical assumption of integration as a 'win-win-option'. For this reason, they do not permit that integration of some CEEC would be partly unsuccessful or fail completely. From this view the prognoses of the CGE models appear to be too optimistic (Kramer (1998), p. 720). Because of their substantially closer connection to the labour market (Belke, Gros (1999)), the development of investment is a far better basis for estimations of labour market impacts (chap. 3.2.2).

3.2.1 Labour market impacts of foreign trade

Baldwin, François, Portes (1997) try to measure the effects of a reduction of trade protection (access to the Single Market and reduction of the common external tariff) on trade flows between the CEECs and the EU and on real income in the involved national economies. They start with an analysis of 'stylized facts' (Baldwin, François, Portes (1997), pp. 129 ff.) First, trade between the CEECs and the EU is mainly characterized as a 'two way trade in similar products' (see also Richter, Landesmann, Havlik (1998), p. 20).[38] For this reason, reciprocal liberalization can force sectors to expand in both regions because of improved possibilities to realize economies of scale. Only in 'chemicals and rubber and plastic goods' and capital goods the EU is a clear net exporter. There seems to be a potential for significant enlargement-related restructuring in the CEECs because these sectors are unlikely to be able to compete in the Single Market. Second, there is a pronounced disparity between the low importance of the CEEC market for the EU exports (1994: 4 % of total exports) and the high importance of the EU market for CEEC exports (1994: 50-60 % of total exports). However, a closer inspection of the average EU figure leads to the result that for Greece (13 %), Finland (11 %), Austria (11 %), and Germany (8 %) the share of exports to the CEECs is at least double than the average. Third, 42 % of EU exports come from Germany. None of the other member states account for more than 10 % of the EU total.

[38] On closer inspection 80 - 90 % of intra-industry trade can be described as an exchange of similar goods of different quality, pushed by differences in endowments. See van Aarle, Skuratowicz (2000), p. 10.

Baldwin, François, Portes (1997) in contrast to Emerson, Gros (1998) state that transaction costs and trade barriers (EU-imposed anti-dumping duties, price fixing arrangements and quotas) between the CEECs and the EU still remain high ("(...) zero statutory tariffs do not mean free trade" (Baldwin, François, Portes (1997), p. 132)). Accession to the EU will reduce both inducing significant welfare gains. Opening to the west and accession to the EU are thus two different things, with the latter having a higher benefit impact for the CEECs (Breuss, Schebeck (1998), p. 749). A comparative analysis of tariff rates show that a) the CEECs are on average more protectionist than the EU and b) that CEEC tariffs on industrial (especially capital) goods are higher and tariffs on agricultural goods are much lower than the EU rates. Since the large share of imports of the CEECs coming from the EU will be totally liberalized by the enlargement, this implies a strong decrease of CEEC tariffs. At the same time the enlargement is likely to increase tariff rates on agricultural goods against third-country suppliers. Because on average only 4 % of exports are affected by accession induced tariff cutting on side of the EU, one can conclude that enlargement will lead to much greater income gains in the CEECs than in the EU. However, as the pattern of trade, the pattern of protection also suggests that restructuring in the CEECs will probably be concentrated in heavy industries (Baldwin, François, Portes (1997), p. 133).

The tendency statements quoted above are clearly confirmed even by the results of the most conservative estimate (i.e. reduction of transaction, but no elimination of risk premiums) of Baldwin, François, Portes (1997).[39] All European regions (thus also EFTA3, ex-USSR and EU15) win by the Eastern enlargement but the CEECs gain relatively much more (about seven times) than the EU. Compared with the base case of no enlargement at all the steady state growth rate of real income will increase by 1.5 % in the CEECs and only by 0.2 % in the EU. Of course, absolute figures are four times greater for the EU15 (9.5 billion ECU), since their economy is twenty times larger than that of the CEEC10 (2.5 billion ECU). As mentioned above, there is a great disparity between EU countries in the pattern of Eastern trade, and therefore the distribution of the gains is unequal. Germany alone gets one third, together with Great Britain and France two thirds of the measured increase of income. These orders of magnitude for the EU (13.3 billion ECU) are confirmed by a methodically deviating study of Brown et al. (1997), which estimate welfare effects of a free trade area between the so-called Visegrad countries (Czech Republic, Hungary, Poland, Slovakia) and the EU. Estimations of Neck, Haber, McKibbin (2000, pp. 77 ff.) with a dynamic CGE model (McKibbin-Sachs global (MSG2) model) partly support the findings quoted above (increase of CEEC-GDP by 1.6 % in the long run, but very small spillovers to the rest of the world) with the difference that they take the reduction of risk premiums into account.[40]

Two core statements of Baldwin, François, Portes (1997) should be noticed. First, the accession to the EU will have great welfare gains for the CEECs, even without consideration of transfers from EU funds and the above mentioned effect on risk premiums. Second, the result

[39] See also Breuss, Schebeck (1998), pp. 745 ff. For a criticism of the methodology of Baldwin, François, Portes (1997) see Emerson, Gros (1998), pp. 25 ff.

[40] Compared with the less conservative estimation of Baldwin, François, Portes (1997), in which they take the risk premium reduction into consideration and find an increase of 18.8 % in the long run, therefore a striking difference is found. See Neck, Haber, McKibbin (2000), p. 81.

of small but significant gains for the EU15 could be used as an argument to refute objections from parts of the EU (society and politicians) regarding the high costs of Eastern enlargement. However, an enlargement induced 'terms of trade-shock' could have negative impacts for the EU in the short run. It expresses adjustment costs of a rich economy (EU in this case), if it is suddenly confronted with cheaper competition from a low wage country (Breuss, Schebeck (1998), p. 747). However, Belke, Hebler (2000) argue that this shock will not be as severe because integration is already executed in decisive parts.

What can therefore be concluded about the labour market impacts of an enlargement induced increase in trade between the CEECs an the EU? The findings of Baldwin, François, Portes (1997) are widely accepted in the literature. At present it is a common view that new member states will gain a major share of the economic advantages of Eastern enlargement because of the proportions to the EU (gravitation models) (Baldwin (1995), p. 480, Kramer (1998), p. 721, Steinherr (1999), Walterskirchen (1998)). However, as the argumentation in chap. 3.1. has led to the result that labour market impacts even on the macroeconomic level will be significant negative the net-gains in trade (and also investment) are unlikely to have stimulating power for employment. The main reason is that trade creation and trade diversion (here: increasing intra-industry trade, see Baldwin, François, Portes (1997), p. 130, Biffl (1998), p. 1, Boeri (1998), p. 2, and Emerson, Gros (1998), p. 19) force the economic restructuring and therefore induce a strong reallocation of labour (Steinherr (1999)). The takeover of labour market rigidities inducing social policy laws at the same time will therefore increase unemployment in the short and maybe also in the long run (Boeri (1998), p. 2). On closer inspection of trade flows van Aarle, Skuratowicz (2000, pp. 17 ff.) come to the result that on the one hand increasing exports to the EU have a strong positive effect on employment and on the other hand imports from the EU tend to reduce employment in the CEECs. Moreover they find that imports from the EU decrease investment as well, whereas exports to the EU tend to increase investment. These results support the well-known story of restructuring of the economy which is by increasing competition. Therefore, it also supports our argumentation. The increasing pressure of restructuring is likely to have negative labour market impacts in the short run with a set of inflexible labour market institutions making it persistent over a longer period.

Further better quantifiable negative labour market impacts will result from a reduction of specific trade protection in the agricultural sector. It can be demonstrated by the example of the Czech Republic, Hungary and above all Poland that fears of the EU of a low wage and price competition with the farmers of the CEECs is not justified. The agriculture of these countries urgently needs a structure improvement, in order to be competitive at all. Even though their prices are very low, the quality and the hygienic standard of their products are probably not competitive on EU markets (Breuss, Schebeck (1998), p. 742, Lankes (1999), Pouliquen (1998), p. 520, Lavigne (1998), p. 52). Direct competition of CEEC farmers with their counterparts in the EU after enlargement is therefore likely to cause a global recession in the CEE agriculture and a further burden to the trade balance with the EU. Because the only potentially competitive sub sector is the grain sector. This development can only be reduced by a rapid approximation of productivity level to the substantially higher EU average by a modernization of capital fund and transfer of Western management techniques.[41] However, this will probably lead to *a sharp decrease of the employment* in the CEE agriculture (Baldwin et al. (1998), p. 87, Pouliquen (1998), p. 518, Wisniewski (1999)). Estimations of the EU Commission (1998) come to the result that an increase of productivity in CEE agriculture to 50 % of the EU level will destroy up to 4 million jobs in the CEEC10, the majority of them in Poland. From this view the entered claim on free access to the labour markets of the EU do not even come surprisingly. These social consequences which manifest themselves in a high migration potential are or should probably be the most worrying point to the EU (Baldwin et al. (1992), p. 87, Lavigne (1998), p. 52, Pouliquen (1998), p. 520, Wisniewski (1999)).[42]

3.2.2 Labour market impacts of a change in foreign direct investment

In a set of studies (particularly at) the Centre for European Policy Studies, Brussels, examined, which scope the FDI flows into the CEECs would have in view of (medium-term expectations of) the Eastern enlargement (Brenton, Di Mauro, Lücke (1998), Emerson, Gros (1998), pp. 30 ff.). In general these studies, based on models for FDI determinants ('gravity models'), come to the result that the advanced CEECs presently register the FDI inflows, which are to be expected due to their present growth of incomes and relative closeness to the EU. They might strengthen moderately by accession (as it was the case for Spain and Portugal at the time of their entry to the EU in the mid eighties). However, by gradual reforms in the advanced CEECs, a degree of openness for FDI has occurred, which resembles southern EU members long after their accession.[43] Accordingly, the main part of the accession-induced increase of the FDI volume has already taken place in Poland, Hungary and the Czech Republic (different from Bulgaria and Romania).[44] To that extent no substantial FDI induced positive labour market effects might occur in these countries in the future. Positive labour market impacts in the further process leading up to the actual entry could result only due to a qualitative modification of (the structure of) capital inflows. If the CEECs becomes less dependent on specific types of capital inflow by a rising proportion of portfolio investments promoting the sustainability of their balance of payment positions (Buch (1999)).

On the other hand, the majority of studies stresses that Eastern enlargement will probably rather force the catching up process of the joining CEECs and therefore induce increasing FDI. By expectations of, preparations for and realization of accession, stability, sustainability

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[41] Many enterprises in Poland and to a smaller extent also in Romania meanwhile converge to the structures and management practices, which contribute in Spain to the competitive ability of the agriculture. See Lankes (1999).

[42] In opinion of Pouliquen (1998) this migration potential can be reduced by a special structure assistance of the EU for the agriculture in Poland. See also Baldwin et al. (1992), p. 87, and Lavigne (1998), p. 52. A detailed analysis of migration potentials of Eastern enlargement will appear in Belke, Hebler (2000).

[43] See in detail Buch (1999), pp. 10 f., and Martín, Velázquez (1997). At one end of the spectrum there is Estonia, which already liberalised all capital transactions in 1994. At the other end there is Slovenia , having pursued the comparatively most restrictive policy. The Czech Republic, Hungary and Poland fall between these two extremes.

[44] Because of other important determinants for FDI inflows (e.g. the supply of qualified labour, Martín, Velázquez (1997)), they tend to concentrate on certain countries and sectors. E.g. 1997 60 % of the FDI currents from the EU into the CEEC flowed to Hungary. See the notes of Barry Eichengreen to Baldwin, François, Portes (1997), p. 174.

and the level of capital inflows increases clearly.[45] The potential improvement of the investment climate in the CEECs (security over the future political and economic course), the decrease of the risk premium on direct investments and the access to the international capital market are seen by the majority of studies as the main advantage of the European Union membership from the perspective of the CEECs.[46] A dissolution of uncertainty reduces the option value of waiting, because FDI flows indicate generally high fixed costs. To that extent almost all studies assume an impulse to FDI from EU countries, as the experiences of Spain and Portugal concerning their entry to the EU and Mexico concerning its entry to the NAFTA suggest (Brenton, Di Mauro, Lücke (1998), p. 12, Martín, Velázquez (1997)).[47] A further determinant of the extent of FDI flows into the CEECs might be the selection of the exchange rate regime (and with it its volatility) in relation to the Euro (Lavigne (1998), p. 43).

Furthermore, it can be argued, accession to the EU accelerates the catching up process, since it guarantees the inflow of structural and other funds of the EU. With these funds human capital and infrastructure could be developed (Cichy (1995), p. 664), which both - looking at the example of Spain - are evident preconditions of an FDI inflow (Martín, Velázquez (1997)). The first argument is often supported by the experiences with Ireland, whose upswing was started up crucially by inflows of EU structural funds. However, the development in another cohesion country Greece shows that structural funds do not guarantee an economic ‘takeoff’, if the ability of a society to incorporate and implement innovations is not sufficient and political and economic institutions are not structured in a way which conforms to incentives.[48] Furthermore, it must be considered that structural funds are connected to single projects, so that just a sufficient ‘absorption capacity’ can guarantee a *steady inflow*. Letter is determined by the ability to provide the necessary co-financing, the existence of an appropriate institutional background on the level of area municipality and the ability to adapt new forms of national and cross border co-operation. It seems, that especially the first few years after the accession can be critical from this point of view. The problem could be easily solved by making the conditions of pre-accession aid similar to the ones of post accession transfers. A high share of approved projects can then be seen as a sign of maturity for full membership (Richter, Landesmann, Havlik (1998), pp. 5 ff.)

The majority of studies see positive labour market impacts of increasing FDI.[49] They force the ‘upgrading’ of the product quality, which implies improved terms of trade and more symmetrical import and export elasticities in comparison to the EU. Devaluation pressure is re-

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[45] See Baldwin et al. (1992), p. 90, Breuss (1998), p. 30, Brenton, Di Mauro, Lücke (1998), p. 2, Cichy (1995), p. 664, Landesmann, Poeschl (1997), Lankes (1999), Richter, Landesmann, Havlik (1998), p. 13.

[46] See Baldwin, François, Portes (1997), pp. 139 ff., 172, 174, Breuss, Schebeck (1998), p. 747, Walterskirchen (1998), pp. 531 ff. As an example Austria can be used, where the FDI has increased *as consequence* of the European Union entry of this country noticeably. See Walterskirchen (1998), p. 532.

[47] This interpretation neglects that in the mid eighties (at the time of southern enlargement of the EU) an increase of global flows of capital was to be registered. Portugal and Spain are therefore also a good benchmark for the CEECs, since they also gave up a status of relative autarchy because of the integration. See Buch (1999), p. 24, and Martín, Velázquez (1997).

[48] See Kramer (1998), p. 722. In the cohesion countries Spain and Portugal the standard of living has only slowly been adapted the EU average.

duced, the structural determinants of trade balances are improved, limitations caused by the balance of payments are also reduced and the catching up process of quantitative growth accelerates (Landesmann, Poeschl (1997), Richter, Landesmann, Havlik (1998), pp. 13 f.). Based by a general equilibrium model it can be demonstrated that a relocation of e.g. 2.5% of the Austrian capital fund to Hungary could increase the real BIP in Hungary on a long-term basis at around 1.3 % (Breuss, Tesche (1994)). Of course the composition of foreign trade and production as well as the resulting *structure of labour demand* determine the exact labour market impacts of a given modification of the FDI volume. A maximum job-creation effect occurs when production moves closer to the structure corresponding to the comparative advantages of the country in question (Baldwin et al. (1998), p. 90, Jovanovic (1999), p. 475). Another relevant factor is the institutionally caused high occupation threshold (by take-over of the acquis, chap. 3.1). Therefore inflows of FDI are also not a universal remedy of unemployment in the CEECs (Biffl (1998), p. 1).

3.2.3 Relevance of asymmetric shocks

Gros (2000) argues that there is unlikely to be any special reason why achieving (and maintaining) fiscal stability will be noticeably more difficult for the CEECs than for EU member countries. What then will be the main problem for candidates once they have joined EMU?[50] Most economists agree that this is the issue of how to deal with the occurrence of asymmetric shocks without disposing of the exchange rate as an adjustment instrument. What risks of asymmetric shocks remain with respect to the CEECs? Or under a more popular heading: *Are the economies of the accession countries similar enough to the EU countries?* An 'asymmetric shock' is a sudden and unexpected disturbance that hits unequally a member state of a currency area. Such a shock may consist either of a disturbance that hits a given region or sector in a particular way, or a shocks that is common to the entire economy, but has differential effects on regions (or member states) because of different economic structures or divergent policy responses. As for economic shocks having a rather equal impact on the whole euro area, the exchange rate continues to serve as an instrument of adjustment, since the euro is floating against the dollar and yen.

In concrete terms the most important asymmetric shocks to have hit the European economy in the last decades have been the two oil shocks of the 1970s, some episodes of sharp turns in US monetary policy and at the beginning of the last decade the German reunification shock. But the shocks that might affect the CEEC-10 in future are likely to come from different sources. There might be some unfinished transition problems left, or shocks that hit most other EU countries equally could hit the candidates in a differentiated way, because of - as stated above - different economic structures or divergent policy responses.

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[49] In contrast van Aarle, Skuratowicz (2000, p. 20) find a significantly negative impact on employment of FDI inflows to the CEECs. As they also see the influence of restructuring and technological catching up in the foreign-owned sectors, one can argue that the negative correlation will disappear in the long run.

[50] Many applicant CEECs regard a membership in EMU as an indispensable complement of economic EU integration, an interpretation which in itself would need a thorough discussion which cannot be led her for reasons of scarcity of room.

The issue of asymmetric shocks is the central element of the so-called OCA (Optimum Currency Area) approach and should thus be the decisive criterion for economists. Unfortunately, however, it has turned out so far that it is impossible to provide quantified estimates of the importance of asymmetric shocks. It is thus impossible in this area to come to any firm conclusions. The OCA literature usually just considers a number of indicators of potential vulnerability to asymmetric shocks, but it has never proven possible to go any further and provide quantitative estimates of the costs of asymmetric shocks.[51]

There are six criteria for assessing the relative suitability of EU economies for membership of the Euro area that are most often used. These indicators are founded on the OCA theory and they all concern the structure of the real economy:

- similarity of trade structures;
- intra-industry trade intensity;
- exports to EU as % of GDP;
- correlation of GDP growth rate;
- correlation of industrial production growth;
- correlation of unemployment rate.

The first three refer to the structure of trade whereas the second group refers to the degree to which the national macroeconomic variables have tended to evolve in step with the EU. This second group is likely to give misleading indications in the case of the CEEC-10 because the correlations would have to be based on data from the last 5-10 years, which were a period of rapid change and shocks of exceptional magnitude.

The data on trade structures might be more useful because some research seems to indicate that after a very rapid change during the early 1990s the patterns of exports and imports of the CEECs has now settled down (Gros (2000)). However, even in this domain one must expect further important changes by 2010. The cases of Portugal and Greece, the two member countries with the lowest income per capita might be instructive in this respect because a priori it is widely expected that these two countries should suffer more from asymmetric shocks than other members of the Euro area. However, this has not happened so far.

Most studies on the trade structure of the candidate countries come to the conclusion that the more advanced group of candidate countries (e.g. Czech Republic, Hungary and Poland) are increasingly entering a mature pattern of intra-industry trade, under which they exchange differentiated products in similar industries, mainly with the EU (see for instance Freudenberg, Lemoine (1999)). This would imply that although these countries are recognizably different from present EU member countries, the likelihood of asymmetric shocks through trade is already at a low level and diminishing. However, this is not the case for the Baltic countries and the Balkan countries, which also lag in preparing for membership. In the case of the Baltic countries it might be that their small size forces them to specialize in a limited number of industries. But given their very high degree of openness, exports accounting for over 50 % of GDP (see table 9 above), they have anyway an interest in joining a large currency area. It is

[51] Belke and Gros (1999) analyse econometrically the importance of (a) the external demand shocks on exports and (b) changes in the real exchange rate over the last 20 years in explaining fluctuations in unemployment and manufacturing production - for all EU economies.

thus difficult to make a priori any firm judgement about the likely importance of asymmetric shocks for the candidate countries should they join the euro early.

Our overall conclusions is thus the following:

- quite a number of structural indicators will continue for some time to indicate that most of the CEEC-10 may be more likely to be affected by asymmetric economic shocks than most EU-15 countries;
- however looking at the actual incidence of such shocks in the past in countries for which similar expectations existed (Portugal, Greece) this finding cannot be taken at face value;
- but still the real exchange rate has proved to be a useful instrument of adjustment in some EU countries, so its cession with adoption of the euro must be balanced by a higher degree of internal flexibility - in terms or prices and wages and labour markets more in general.

4 Conclusions

In the last paragraph the opportunities and risks of the Eastern enlargement for the labour markets of the CEECs have been pointed out. It has been shown that the risks outweigh the advantages particularly because of the institutional effects of the take over of the acquis. Prognoses of foreign trade and FDI induced labour market impacts remain speculative because of the restrictions of the models used. Beyond that the actual accession will probably not represent a significant positive shock for CEECs, since a majority of this shock has already occurred from an expectation of the enlargement.

We see substantial dangers for the job market development in the CEECs by the inevitable adoption of inefficient European Union regulations of social and labour policy via the acquis communautaire. Thus, the rather negative results for the CEE labour markets obtained in this study, covers with scepticism prevailing meanwhile in the population of the CEECs in relation to the EU integration. The exposure of the dangers enables a rational discussion of this extremely important policy issues. Our results and remarks are not to be interpreted however as a fundamental refusal of the integration of Eastern Europe. Rather they clarify that the integration method designated at present has substantial costs – last but not least for the labour markets in 'East and West'. Indeed negative repercussion effects on the EU should not be too large, given the minor economic importance of the CEECs for many EU countries, the migration flows to be expected and the degree of integration which has already taken place.

Which are the political implications of the results obtained in this study? The sense of a adoption of the social Charter by the CEEC, which is forced by the acquis communautaire, appears doubtful from a labour market-political view. Because the ongoing crisis of CEEC labour markets can mainly be explained by institutional determinants which are also responsible for the recovering of labour demand after cyclical recessions in the EU. Institutionally caused persistence of shocks have become an integral item in the analysis of labour market dynamics in most Western European economies. Since the CEECs without an appropriate derogation in the accession negotiations import institutions of labour and social policy from the EU, this institutionally caused persistence of unemployment will increasingly be important for the discussion of labour market dynamics in this countries.

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