EASTERN ENLARGEMENT OF THE EU: FACTOR MOBILITY AND TRANSFERS - Which Matters Most?

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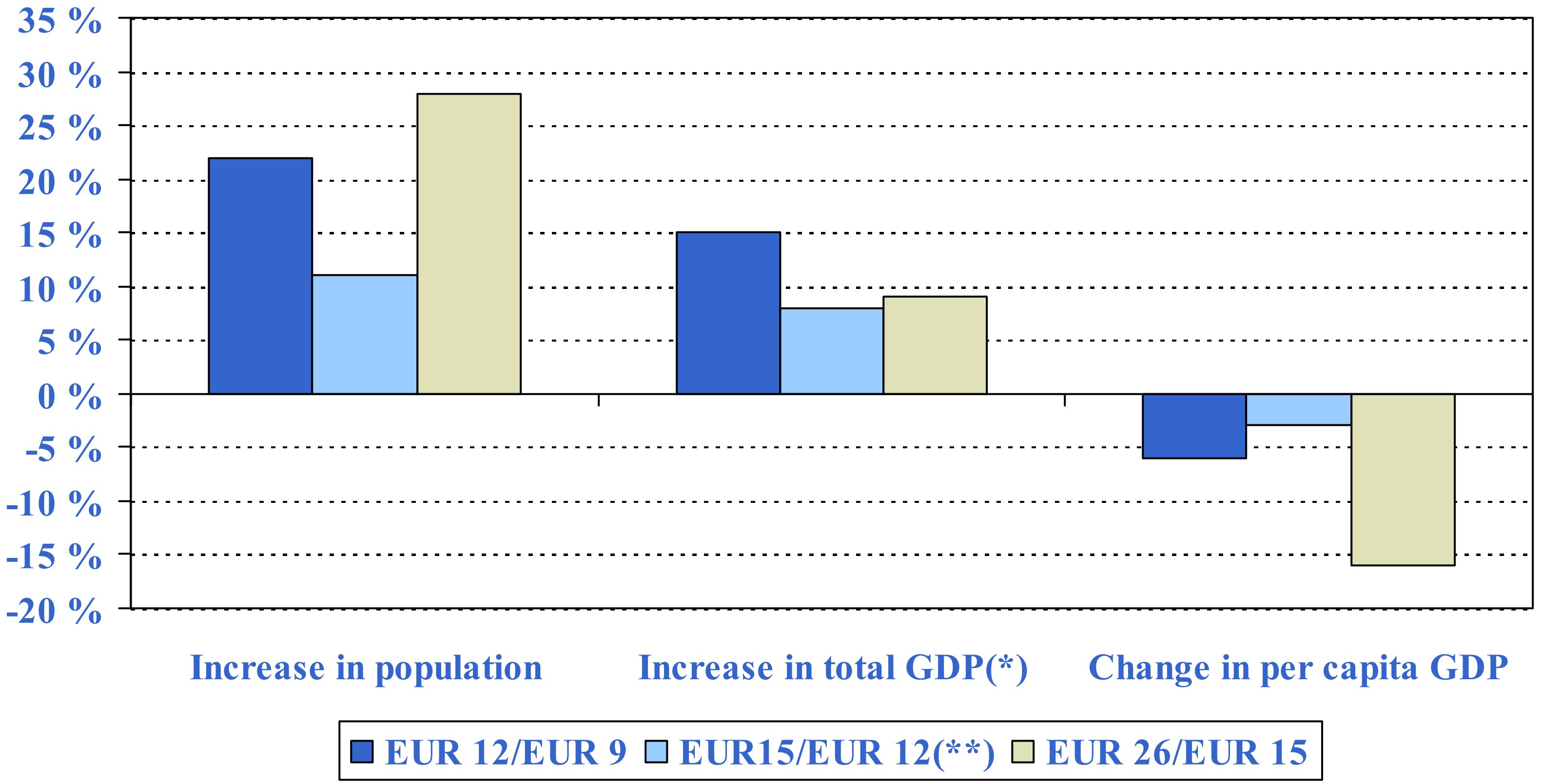
EASTERN ENLARGEMENT OF THE EUROPEAN UNION

- Expected to take place 2004-2005
- Different from the previous enlargements
  - Relatively poor transition economies are integrated to the EU's economic and regulatory structures
  - First time in successive enlargements the incumbent EU has to reform its institutions
- What does it involve
  - Trade and structural policy shocks
  - Factor mobility (free movement of capital and labour)
- How it is modelled
  - Dynamic CGE

KEY MAGNITUDES IN SUCCESSIVE ENLARGEMENTS OF THE EU



* Purcahsing power values

** Includes German Unification

FACTORS IN THE EASTERN ENLARGEMENT

- Trade Policy
  - Custom Union
  - Common Agricultural Policy (CAP)
- Institutional Changes
  - Common markets implies common
    - Legal system
    - Industrial standards and regulation
    - Administrative procedures
  - Regional Cohesion
    - Structural funds
- Factor Mobility
  - Investments to East
  - Migration to West

→ **Income convergence**

DYNAMIC GLOBAL TRADE MODEL

- Dynamics as an add on to comparative static multi-regional trade model (standard GTAP)
- Accumulation dynamics adopted from Australian MONASH -model
  - Sector specific capital in Ricardo-Viner -fashion
- Sluggish labor markets from Solow (1990)
- Cross regional wealth accounting McDougall and Ianchovichina (2000)

TRADE POLICY

- Europe agreements
  - EU has bilateral free trade with 10 associate countries, except in agricultural products
- Custom union
  - Entrants have on average higher tariff protection and different tariff structure than EU-15
  - CEA’s have higher tariffs in heavy industry and lower in food production
- Common agricultural policy
  - CEA’s have low protection and no export subsidies
  - EU have high protection and export subsidies and large variety of other policy related transfers

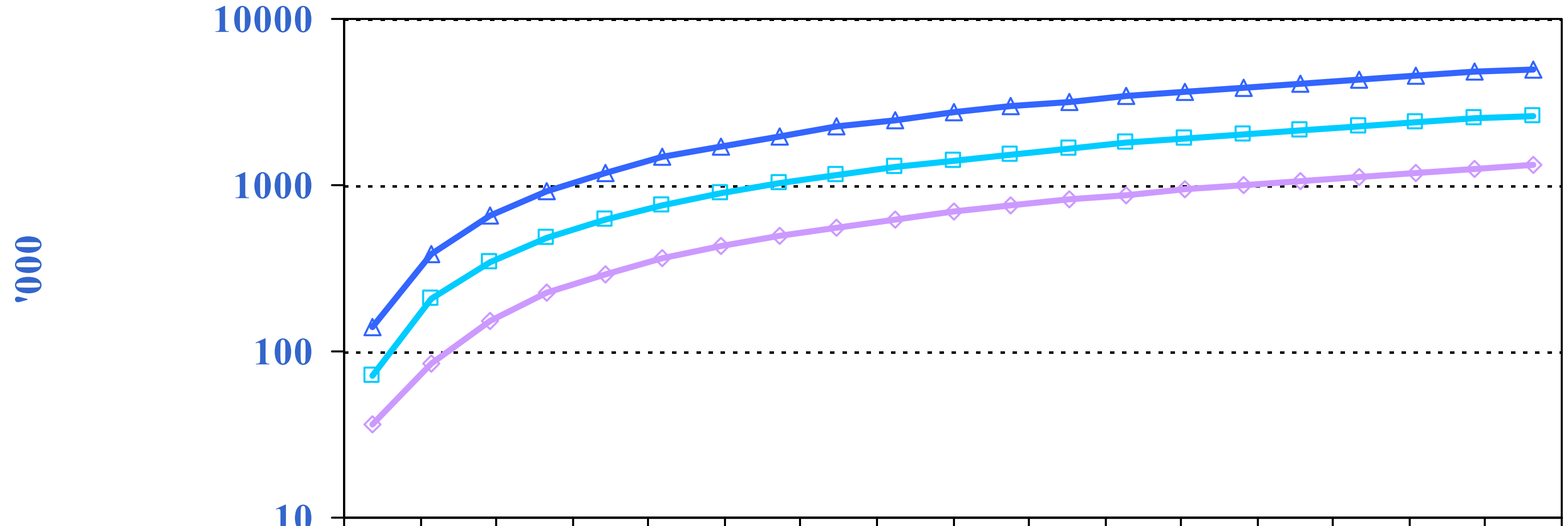
SIMULATION SCENARIOS - EU POLICIES

- SCENARIO 1: Trade Policy
  - Formation of custom union
  - 10% decrease in the transportation costs due to integration
  - Introduction of Common agricultural policies (CAP) into CEAs
- SCENARIO 2: Structural Funds
  - SCENARIO 1 and gradual adoption Structural Transfers (modelled as asset price subsidy)
  - Appropriations from funds initially 3750 million euros rising to 12.080 million in five year period

SIMULATION SCENARIOS - *INTERNATIONAL FACTOR MOBILITY*

- Scenario 3: Capital Mobility
  - Scenario 2 and 15% decrease in the required rate of return on capital in CEA due to increased business confidence
- Scenarios 4-6: Various Labour Mobility Alterna-tives
  - Labour Mobility Depends on income differences
    - In alternative scenarios different sensitivity of mobility to income differences
    - Mobility declines gradually when incomes converge
  - Labour force migration from the CEA's to the EU
    - Scenario (5): 70,000 persons annually (~0.7 million in 10 years)
    - Scenario (5): 140,000 persons annually (~1.4 million in 10 years)
    - Scenario (5): 280,000 persons annually (~2.8 million in 10 years)
    - Total migration assumed to be twice of labour force mobility

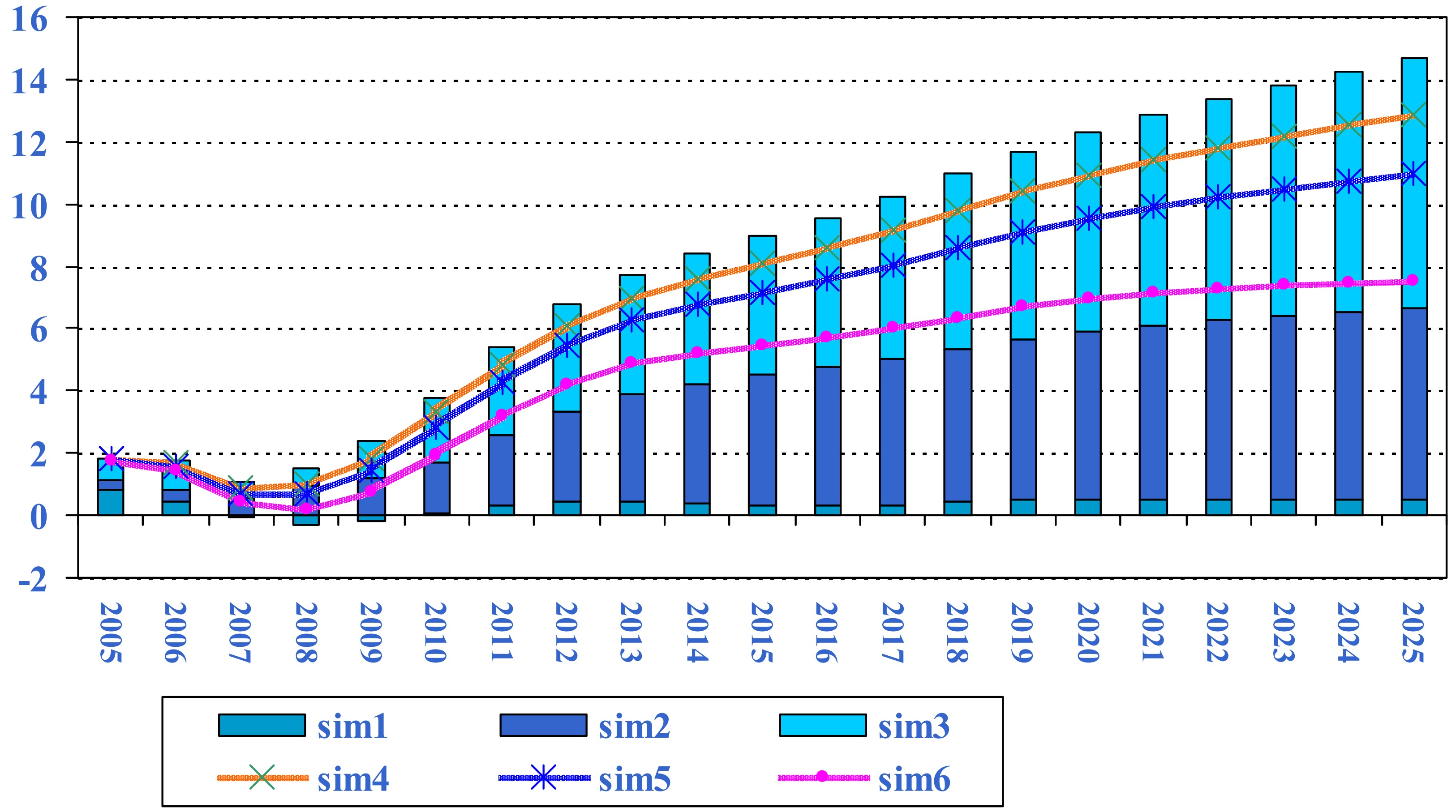
EMPLOYMENT CHANGES IN THE PRECENT EU IN MIGRATION SCENARIOS



	2005	2006	2008	2009	2010	2012	2013	2014	2016	2017	2018	2019	2021	2022	2023	2025
Employment 1	36	84	223	291	360	493	559	624	753	817	881	943	1068	1129	1190	1310
Employment 2	71	209	485	622	757	1021	1150	1278	1531	1656	1780	1902	2144	2262	2380	2613
Employment 3	142	383	928	1197	1462	1976	2227	2474	2959	3198	3433	3665	4120	4343	4563	4995

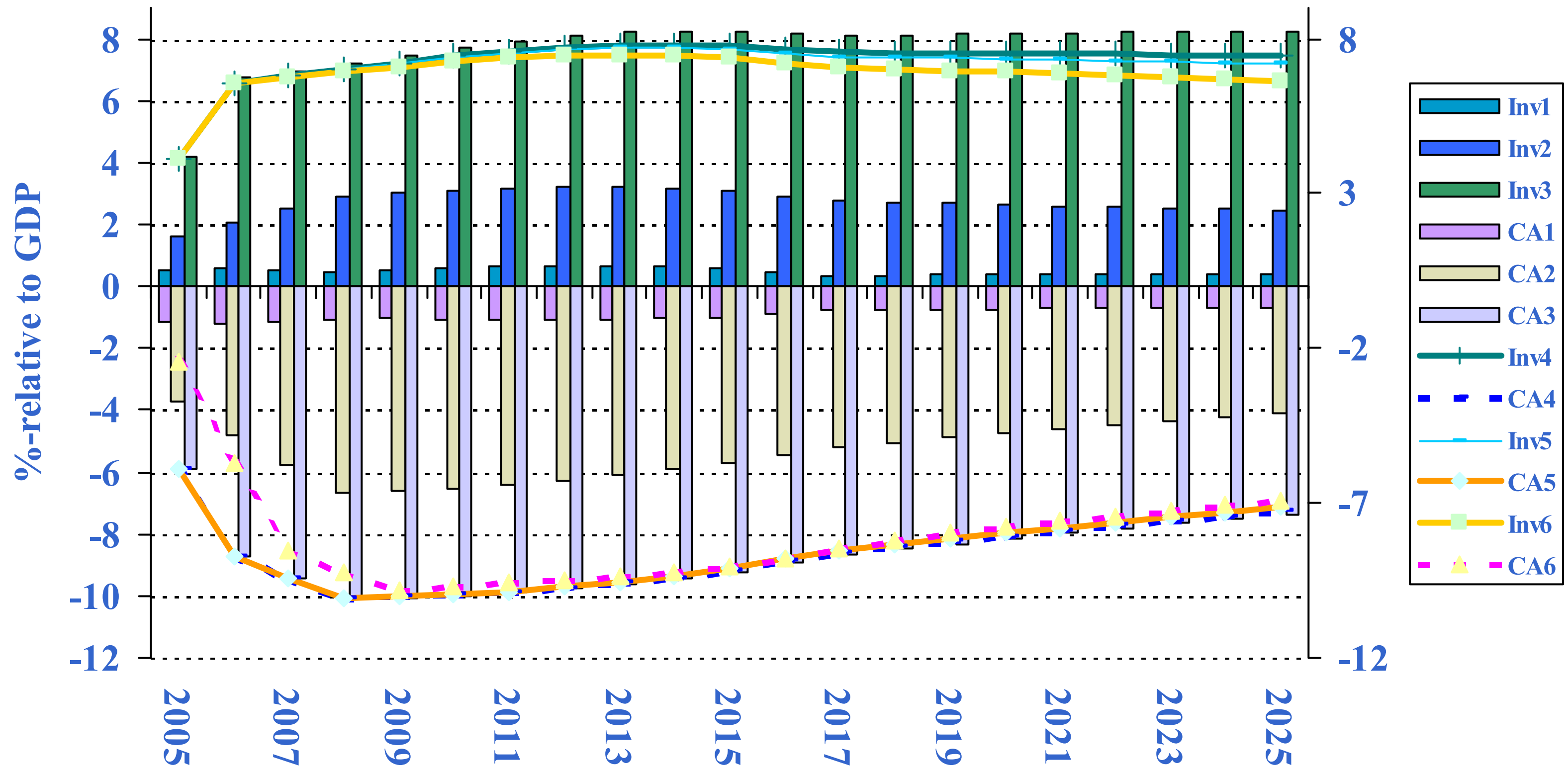
CHANGES OF GDP IN THE CEAs

%-deviation from baseline



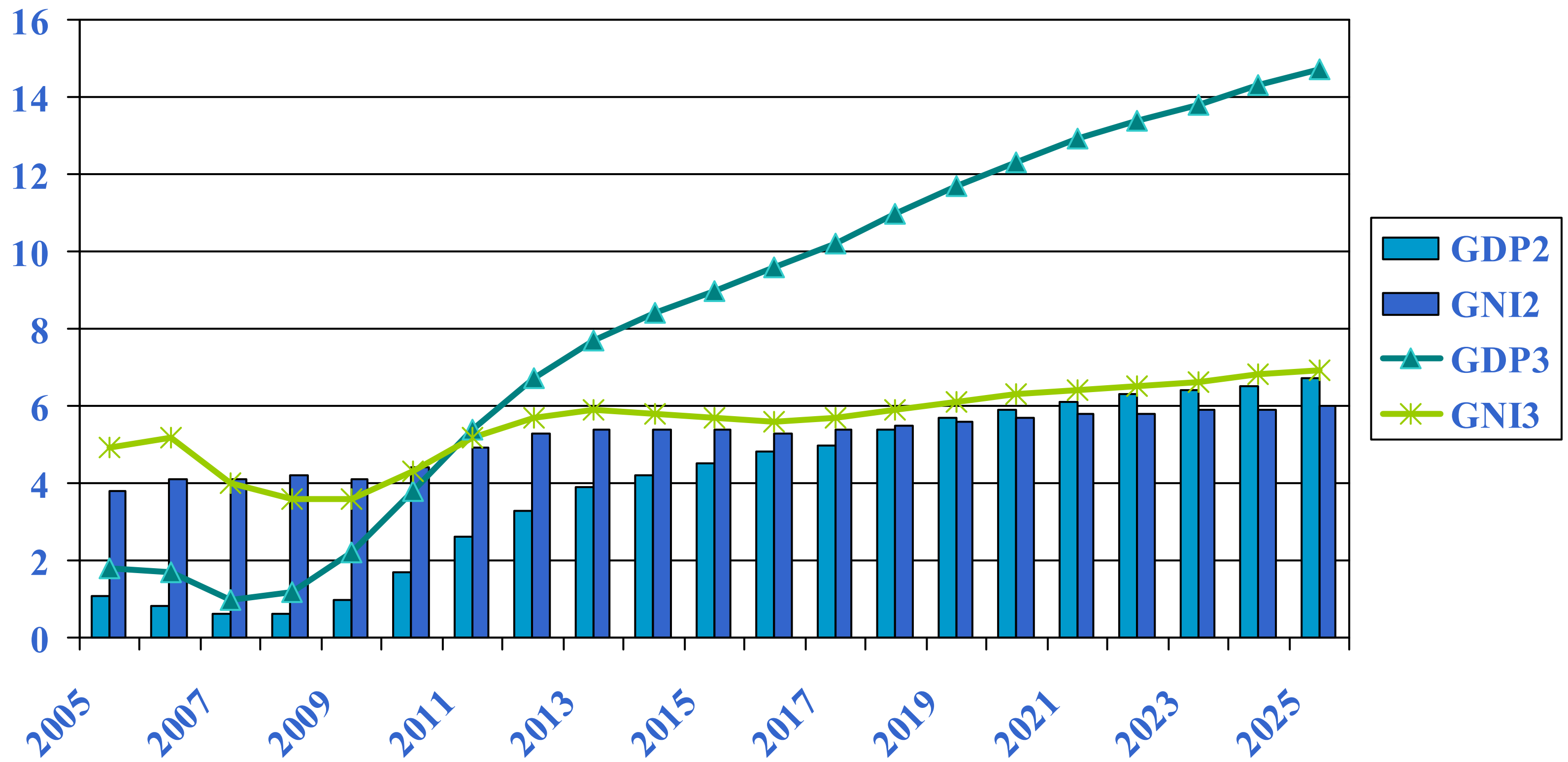
INVESTMENTS AND CURRENT ACCOUNT IN CEAs

deviations from baseline



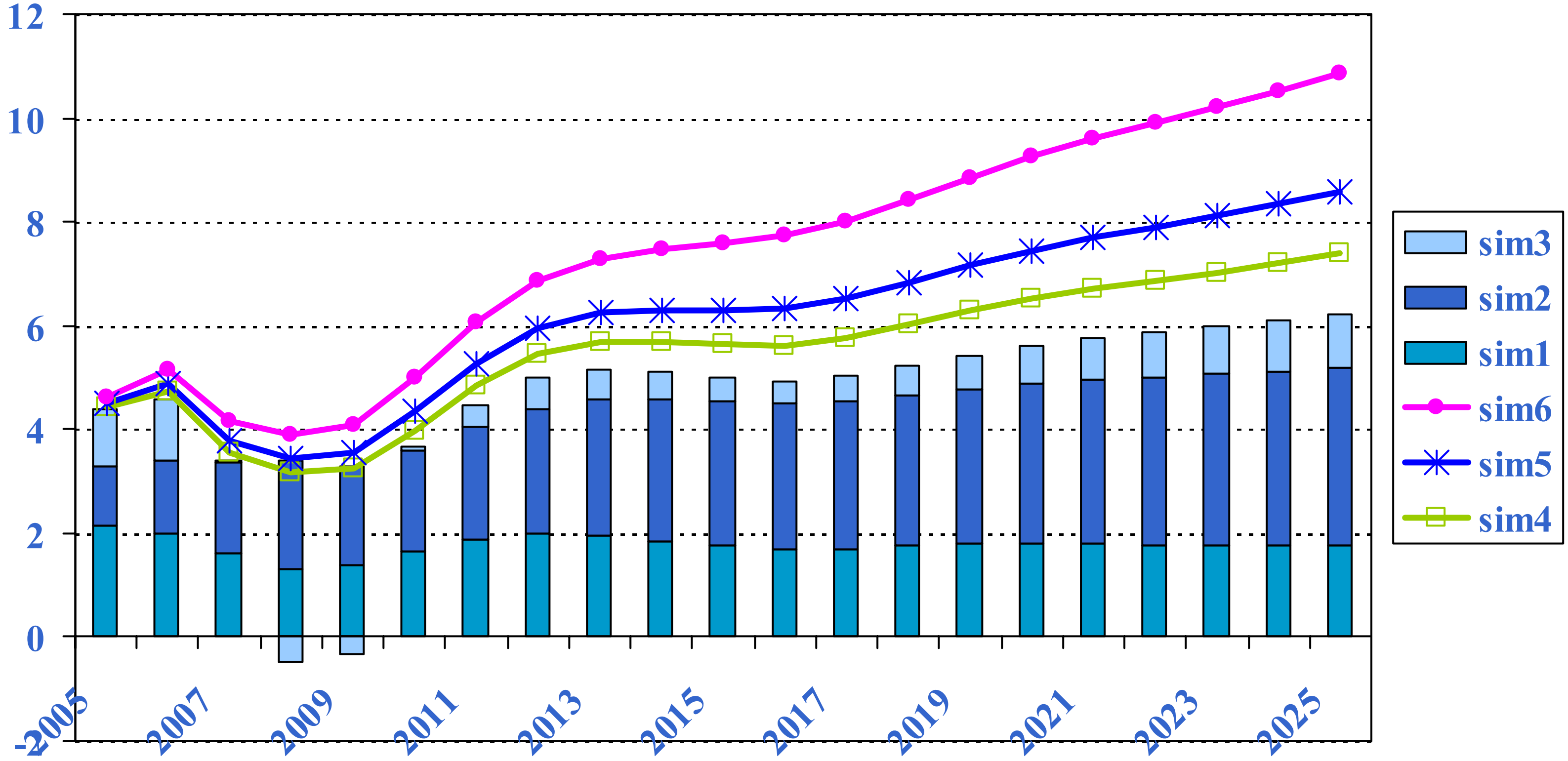
GDP VS. GNI IN DIFFERENT SCENARIOS FOR THE CEAs

% deviation from baseline



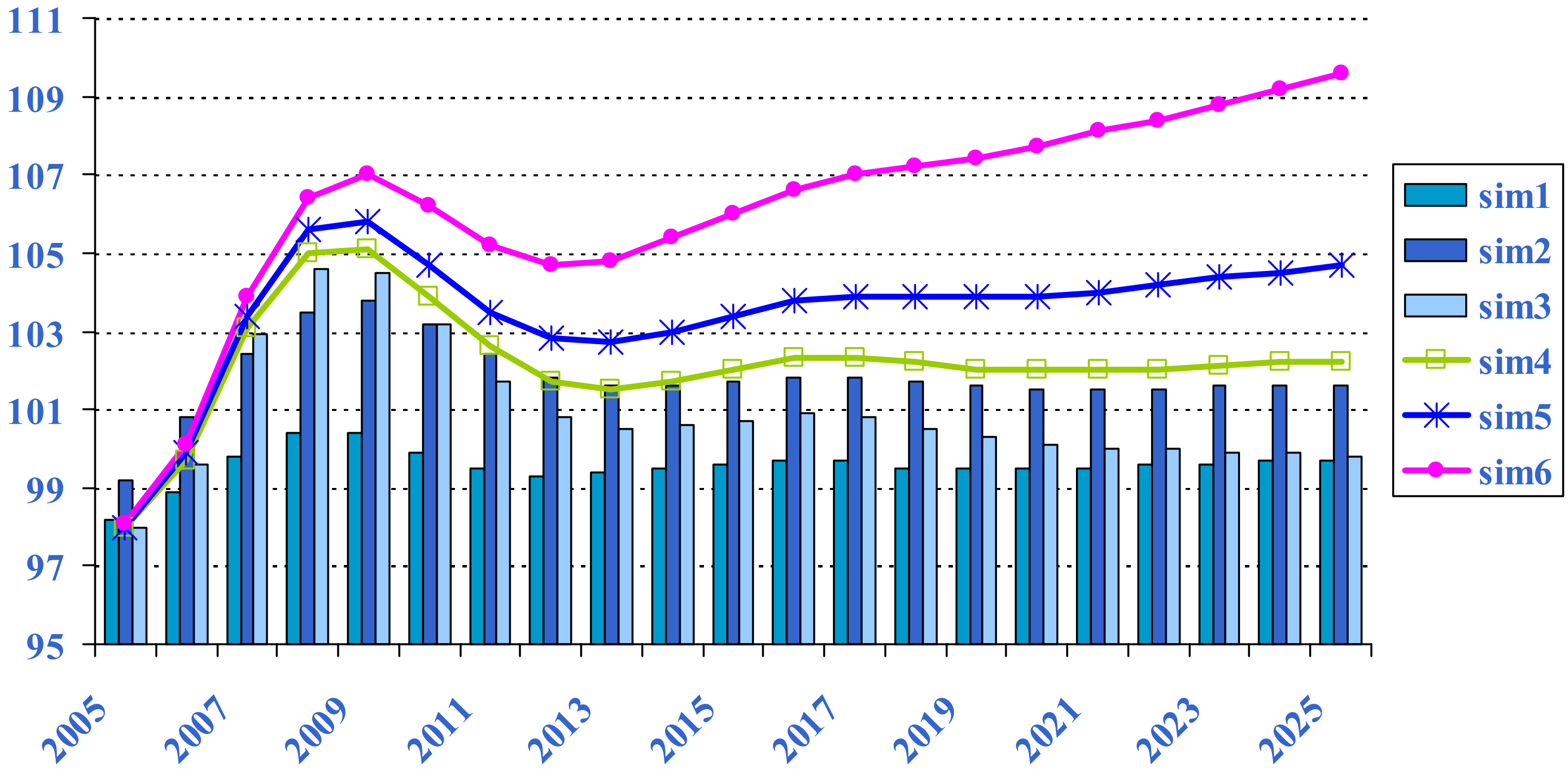
CONSUMPTION PER CAPITA IN THE CEAs

%-deviation from baseline



WAGES RELATIVE TO GDP IN THE CEAs

deviation from baseline



CONSUMPTION PER CAPITA IN THE CURRENT EU

%-deviation from baseline