

UPDATE ON ENLARGEMENT OF THE EUROPEAN UNION

by William P. Bomersheim
Agricultural Marketing Specialist

Enlargement of the European Union (EU) is a major undertaking. If all the current candidates were admitted today, the EU's land area would increase by 34 percent, its population would grow by 29 percent, while per capita GDP would fall by 16 percent. Instead of 15 member states, the EU would encompass 27 countries. Each country brings its own language, cultural and historical traditions, and significant political and demographic differences. In addition, enlargement of the EU would greatly increase income disparities among member states. Many of those who note how difficult it is for the EU to make tough decisions today (with only 15 member states of roughly equal levels of development) question how a union of 27 could function at all. Nevertheless, all of the governments involved, and the majority of European citizens both inside the EU and in candidate countries agree that EU enlargement is desirable - and inevitable.

Cooperation and The Europe Agreements

After the collapse of the Berlin Wall in 1989, relations between the European Community and the countries of Central and Eastern Europe changed dramatically. Soon after the collapse, the European Community decided to embrace countries in the region to promote peace and stability.¹ The Community removed import quotas on numerous products, extended the Generalized System of Preferences (GSP) and began negotiating Trade and Cooperation Agreements with countries in the region. By the mid 1990s, the EU had concluded agreements with Bulgaria, the Czech Republic, Slovakia, Estonia, Hungary, Latvia, Lithuania,

Poland, Romania, and Slovenia.²

Table I

Country	Europe Agreement in Force	Official Application for EU Membership
Bulgaria	Feb 1995	Dec 1995
Czech Republic	Feb 1995	Jan 1996
Estonia	Feb 1998	Nov 1995
Hungary	Feb 1994	March 1994
Latvia	Feb 1998	Oct 1995
Lithuania	Feb 1998	Dec 1995
Poland	Feb 1994	April 1994
Romania	Feb 1995	June 1995
Slovakia	Feb 1995	June 1995
Slovenia	Feb 1999	June 1996
Turkey	Dec 1964	April 1987
Malta	April 1971	July 1990
Cyprus	June 1973	July 1990

The Europe Agreements are primarily designed to establish free-trade areas between the EU and associated countries. However, in addition to the liberalization of trade, the Agreements contain provisions regarding the free movement of services, payments, and capital, and also aim to extend cooperation in areas such as industry, environment, transport and customs. The ultimate objective of the Agreements is to prepare countries for EU accession by getting them to begin approximating their legislation to that of the European Union.

One result of the Europe Agreements has been a dramatic increase in trade between the EU

¹Note that in the wake of World War II, the European Community was created not for the purpose of fostering "free trade" as much as to make another war between Germany and France, or other nations in Europe unthinkable.

²The European Community had already established similar Association Agreements with Turkey, Malta, and Cyprus. In the case of Turkey, a Customs Union entered into force in 1995.

and the countries of Central and Eastern Europe. Before the Europe Agreements were negotiated, most trade in the region was directed eastward. Today, however, the vast majority of exports are targeted to the EU. In many sectors such as furniture, as much as 90 percent of production is exported westward. EU imports of solid wood products from the ten Central and Eastern European candidate states, for example, have nearly doubled since 1994, reaching \$3.96 billion in 1999.

In addition, the Agreements have spawned major structural changes in candidate countries and fostered increased foreign investment. In Poland, for example, the wood processing sector has undergone massive privatization. By 1999 more than 93 percent of the entire wood and furniture industries had been privatized. Increased German investment helped make the Polish furniture industry the third or fourth largest in Europe - with nearly all of the production targeted back toward German and other EU markets.

In Estonia, free trade with the EU, coupled with measures designed to protect property rights and stabilize the economy helped to attract much needed investment in sawmills. According to the Estonian Investment Agency, as much as 45 percent of Estonian mills are now owned by companies headquartered in the United Kingdom, Finland, Sweden, Ireland and Denmark. Again, production is targeted toward customers elsewhere in the EU.

In total, for the ten candidate countries in Central and Eastern Europe, the stock of foreign direct investment has nearly doubled, increasing from \$33 billion in 1995 to \$63.4 billion in 1998.

The *Acquis*

Last December the members of the EU concluded the Treaty of Nice, concerning voting rights within the Union's governing institutions. Conclusion of the Treaty removes the last formal institutional barrier to enlargement and is considered a major step towards enlargement. However, the EU has been holding out the promise of membership to

countries in Central and Eastern Europe for more than a decade, and much work remains to be completed.

Before being admitted to the EU, each candidate country must adopt the whole body of current EU law - some 80,000 pages of laws and regulations broken down into 31 chapters known as the *acquis communautaire*. In many cases this involves reforming whole sectors of the economy, closing down state-supported industries, and engaging in other less than popular reforms.

Negotiating these chapters also involves negotiating difficult issues in areas such as agricultural reform in the EU. While some of the most difficult issues remain, the EU and at least a couple of the candidate countries have been able to close as many as 18 of the 31 chapters (see Table II). Some officials are optimistically reporting that negotiations could be completed, and EU membership could be granted to at least a few of the candidates as early as 2004.

Impact on the Forest Products Industry

While EU accession is being touted by many in Central and Eastern Europe as a panacea, much of the impact has already been felt. Through the Europe Agreements, the candidate countries have already gained access to EU markets. Harmonization of regulations has begun, and investment has received a shot in the arm.

While a dramatic change is unlikely, the wood products industry should expect continued growth of trade and investment after accession. Investors in countries such as Germany and Sweden are likely to continue investments in plant and processing facilities in the new member states. In turn, these facilities are likely to continue producing wood products for markets throughout the EU. Since 1997 EU solid wood imports from the world have grown by about three percent per year while imports from the ten candidate countries in Central and Eastern Europe have grown by an annual average of nine percent. The EU imported \$3.96 billion of solid wood from the ten

candidate countries in 1999, nearly 1/3 of all its solid wood imports.³

The biggest change from accession is likely to result from adoption of EU laws and regulations. For example, some in Germany have argued that Germany and other established EU countries will become more competitive as the new member states adopt EU labor and environmental standards. However, this may be offset somewhat by the fact that rules imposed from Brussels are also likely to increase business confidence and ensure that the sort of crony capitalism found elsewhere in "transition markets" is eliminated.

Finally, most analysts have been counting on accession to bring economic growth to the new members. Some point to the experiences of Ireland, Spain, and Portugal which have grown rapidly since joining the EU. These countries have become some of the best U.S. wood product markets in the world. Hence, strong economic growth in Central and Eastern Europe could also bring opportunities for U.S. producers. Total U.S. solid wood exports to Central and Eastern Europe currently range from 10 to 20 million dollars. However, markets for certain products such as hardwood lumber and veneer, windows, doors, and builders carpentry items could grow significantly.

As consumer incomes increase, demand for new housing, renovations, new cabinets, doors, windows, hardwood floors, decks, furniture, and other wood products will also increase. In addition, the process of accession is likely to lead to improved mortgage systems and increased ability to finance housing and renovations, thus providing a further boost to wood demand.

EU accession is a major undertaking. However, even though none of the former "East Bloc"

countries have been admitted to the EU, the accession has already begun. As the work of accession continues, the U.S. forest product industry should expect competition from Central and Eastern Europe to continue, but it should also gradually begin to discover export opportunities in the region as well.

³Free trade with the EU gives candidate countries a modest advantage over U.S. wood producers. EU tariffs are already zero for U.S. logs, softwood lumber, and many species of hardwood lumber. EU duties for other U.S. solid wood products range from zero to seven percent.

