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After enlargement: Institutional achievements and prospects in the New Member States

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1 Introduction

May 1 2004 will undoubtedly be seen as an important event in European history. The enlargement of the European Union from 15 to 25 Member States is not only the biggest enlargement in the history of the European Union so far but it also has deep historical significance. It represents the definite end to the cold war and to the geopolitical configuration of Europe into two opposite blocks. It also represents the end of the transition process from socialism to capitalism for most of the new Member states (with the exception of Malta and Cyprus), a process that started in 1989 with the fall of the Berlin wall and the unexpected collapse of communism following Gorbachev's perestroika. Try to imagine the pride of a Czech citizen who 15 years ago was not even allowed to travel abroad and since May 1 passes through the EU passport control in any of the European airports today and you will get a feeling for the exhilaration associated to such a historical event.

Despite all the cheering at this historical event, there is still an enormous amount of ignorance about the realities of the New Member States. Changes in the transition countries of Central Europe and the Baltics have been so rapid that even the experts have had a hard time following them. Many questions are thus raised in this context.

First of all, can we say that the New Member States have achieved their institutional transition in a stable and satisfactory way? Answering this question is quite important to get a feeling of what the Single Market will be in a Europe of 25. The economic weight of the New Member States is not that huge but fears have been expressed that an unachieved or unstable transition could have many negative spillover effects on the functioning of the European Union, especially if these countries are to join the EMU in a short period of time.

Second, has the EU played a positive role in helping those countries achieve their transition? It is quite striking that the transition performance in the new Member States compares very favorably to the dismal outcomes observed in most of the former CIS countries. Has the EU acted as an external anchor for institutional changes in those countries?

Third, given the experience of the new Member States with large scale reforms, is there anything that the EU can learn for its needed structural reforms in labor markets, pension and welfare reform? Have the New Member States been "leapfrogging" the EU in terms of structural reforms?

Finally, how will the EU work with 25 and what will be the contribution of the New Member States?

I will try to give as best as possible of an informed answer to those questions in this report. As far as the first question is concerned, there is no doubt in my mind that the New Member States have truly graduated, they have now over 10 years of experience with fundamental market institutions and these institutions are well established and solid. This does not mean that the economic transition is completely over. A lot still needs to be done in the areas of enterprise restructuring. The former state sectors in those countries will remain fragile for quite many years. This implies a danger of lingering soft budget constraints and of ensuing fiscal imbalances. However, I am confident that these problems, which might be obstacles to entry into EMU, can be overcome in the coming years.

In answer to the second question, I will argue that the EU has played a fundamentally positive role in anchoring the institutions of the new Member States to sound market systems. This is due not only to the positive effect of prospective entry on reform efforts in the new Member States but also to quite close monitoring of the implementation of the *acquis*. While bureaucratic and dull, that process has greatly contributed to institutional stabilization in the new Member States just as the Maastricht criteria helped many EU members to fundamentally improve their public finances. Once inside the EU, the enforcement power

towards those countries will be much smaller just as the stability pact today provides less incentives for EMU members compared to the Maastricht criteria as we have observed in reality. Poland, the biggest of all new Member States and also the one that has led the political and economic transition process since 1989, has been one of the most reluctant countries in implementing the *acquis* and I predict possible tensions in enforcement of EU law with Poland. Enforcement of EU law will be an important topic in the coming years in the EU in general.

The answer to the third question is a bit more disappointing. There is a widespread perception that the New Member States have gone farther in their structural reforms than "Old Europe" but the data show on the whole that this is not the case. The new Member States will thus also need to participate in the necessary structural reforms ahead and in the long delayed implementation of the Lisbon agenda. While limited progress has been achieved with pension reforms that are sometimes ahead of what existing EU members have done, further labor market reforms will be very much needed in the new Member States.

The answer to the fourth question is more speculative. On the whole, I predict that the new Member states will be active, enthusiastic and loyal participants in the enlarged EU. They will add their own voice, as they already have for example in the Convention for the preparation of the European Constitution, and this must be truly welcomed. The enlarged EU will have a Constitution that will contribute to greater efficiency and legitimacy in decision-making. There will not be and should not be a "core" and a "periphery" in the enlarged EU. The center of gravity in Europe has definitely moved East and the role of the Franco-German axis will be smaller than in the past.

2 The overall achievements of the New Member States

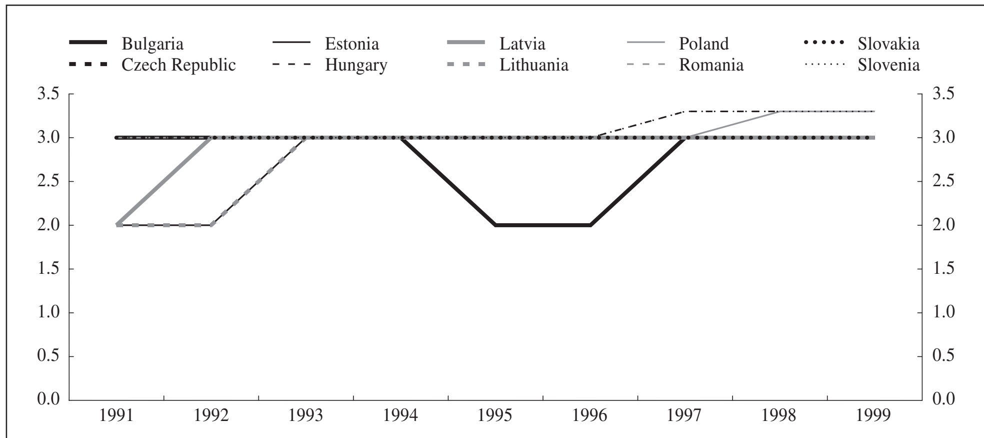
How far have the New Member States really gone in their reforms and what exactly have they achieved? In what follows, we look at a battery of indicators for the countries that entered the EU on May 2004 but also for Bulgaria and Romania who are later in their reforms but will enter the EU in 2007. We use the word "New Member States" for all these countries without distinction.

We present data compiled by the EBRD and the World Bank. These data are far from perfect and some are rather sketchy and sometimes only based on expert opinion. They should thus be taken with a grain of salt. However, they do provide a useful basis to compare country evolutions.

Figure 1 gives the evolution of the EBRD index of price liberalization. Note that an index of 3 indicates very comprehensive price liberalization comparable to advanced industrialized countries and an index above 3 is an indicator of even more advanced price liberalization.[1] We see clearly that price liberalization has been implemented at the beginning of transition and has been there for over a decade. We have only one episode of policy reversal in Bulgaria in 1995-96 when the communists came back to power. The policy was reversed after the communists lost the election. Note that Hungary, Poland and Slovenia are even quite advanced.

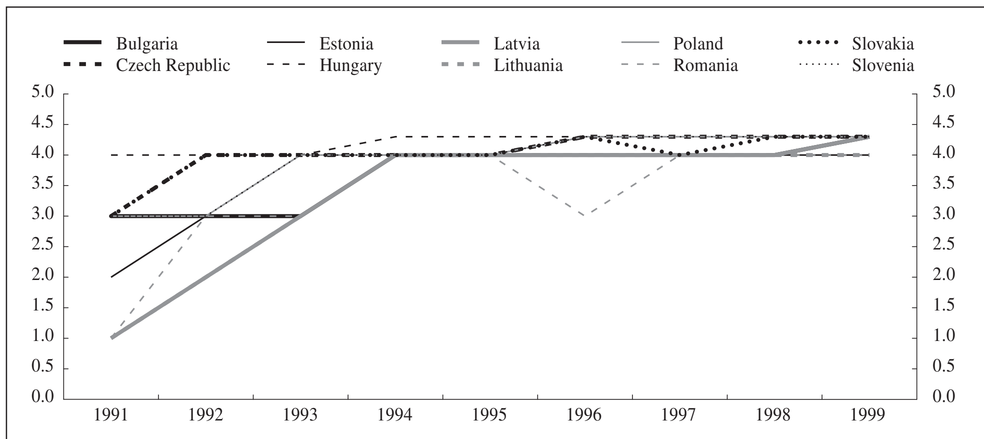
[1] Note that the EBRD has changed their index in recent years as well as the scale of their index. For the sake of consistency, due to definition changes in the variables, we usually present data until 1999. As we will see however, nearly all reforms were achieved by then.

Figure 1: EBRD index of price liberalization



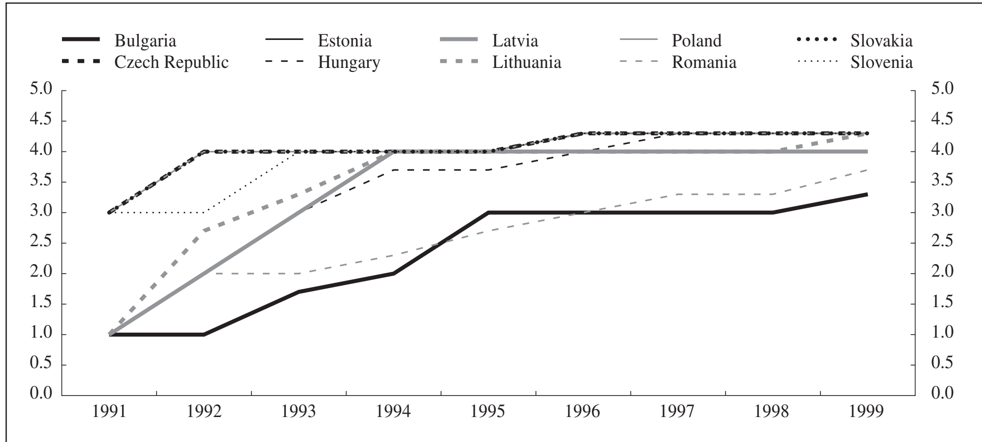
Implementation of trade liberalization is depicted in figure 2. The picture that emerges is quite similar and even more dramatic. All countries have achieved a score of 4 which is the standard for advanced industrialized countries early in the nineties. Note only one temporary reversal in one country, Bulgaria in 1996. Overall, the New Member States have thus been liberalized for over a decade and no serious reversal or even reversal trend has occurred.

Figure 2: EBRD index of volume of foreign exchange and trade liberalization



The dynamics of small-scale privatization is shown in figure 3. With the exception of Romania and Bulgaria who have been somewhat lagging behind, comprehensive liberalization (an index of 4) was usually achieved within a few years after the beginning of transition. Obviously, the Baltics started the process later since transition started in 1992 after the breakup of the Soviet Union.

Figure 3: EBRD index of small-scale privatization



When it comes to large-scale privatization, it is well know that different methods were implemented with the Czech Republic opting for mass privatization and Hungary and Poland for a policy of gradual sales. However, when looking at the dynamics of the EBRD index of large-scale privatization in figure 4, one sees that with the exception of Romania that was trailing a bit, all countries were between the index of 3 and 4 at least since 1997. The large waves of privatization are thus behind us.

Figure 4: EBRD index of large-scale privatization

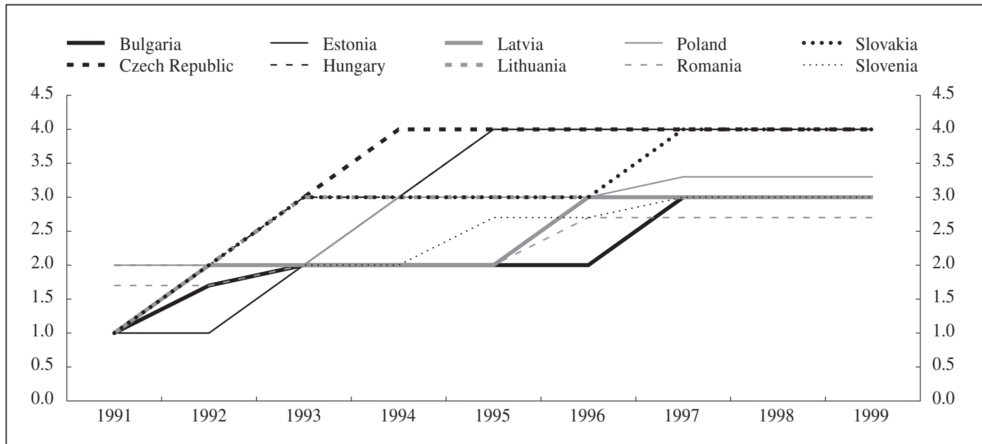


Figure 5 looks at the index of enterprise reform constructed by the EBRD. It captures not only the intensity of restructuring activity but also the degree of hard budget constraints and improvements in corporate governance. The picture here is less rosy. An index of 4 and above is the index for the most advanced countries. Against that benchmark, progress has been clearly slower and has even been pretty stagnant since 1997. Things are changing only very slowly. Unfortunately, figure 5 only gives consistent time series until 1999 but there have not

been major changes in recent years. It is thus safe to conclude that changes have been slower here. While the picture is a bit more disappointing than for other dimensions of reform, we should not be too surprised either. Eliminating soft budget constraints is a difficult process that was not well understood in the beginning of transition and is still not very well understood, certainly in policy-making circles (for a survey, see Kornai, Maskin and Roland, 2003). Since the beginning of the transition process restructuring was predicted to be the most painful of reforms and among those to be achieved the latest (Roland, 1991). While much defensive restructuring has been taking place in the last 15 years, strategic restructuring which involves investment, know how and insertion in modern supply chains has been rather slow. The economic landscape has been transformed beyond recognition since 1990 but many of the former State-Owned Enterprises are far from having achieved their restructuring process. One has to be fully aware that enterprise restructuring is still an important weakness even in the more advanced transition countries. There is no reason to believe that things are going in the wrong direction but this will remain a fragile spot in the coming decade.

Figure 5: EBRD index of enterprise reform

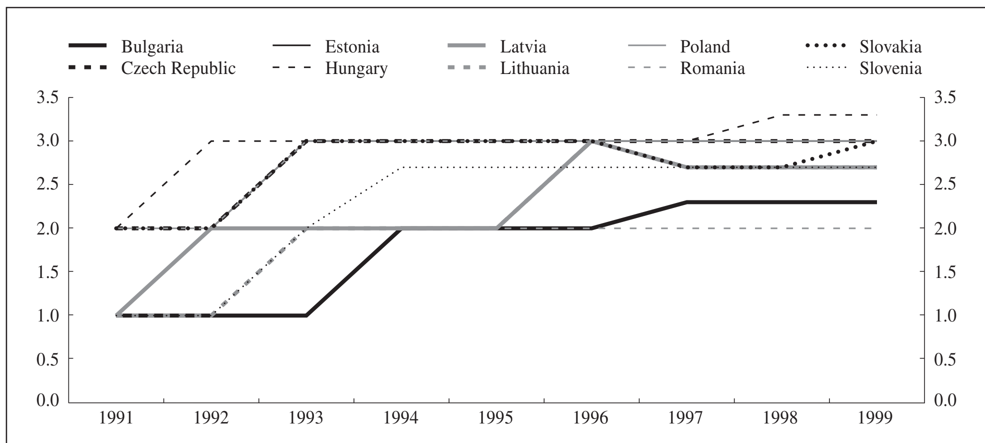
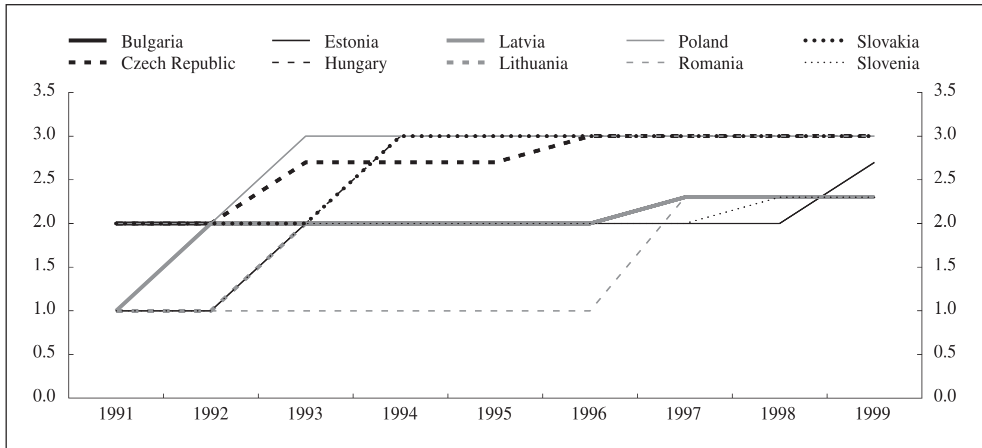


Figure 6 displays the EBRD index of competition policy implementation. This is a broader index than the EU index of conformity with competition law presented in the appendix. One sees that Hungary, Poland, the Czech Republic and Slovakia were the most advanced. The Baltics, Romania, Bulgaria and Slovenia were somewhat lagging behind. The overall situation can nevertheless be judged as relatively satisfactory. Nowhere does one see situations of monopoly or monopoly rent-seeking like in the CIS. Competition policy has been addressed rather early on in transition and this is clearly an area where the prospect of EU accession has played a positive role.

Figure 6: EBRD index of competition policy



The dynamics of reform of banking institutions is shown in figure 7. One sees that the situation was generally good towards the end of the nineties. An index of 3 indicates a functioning banking system with liberalized interest rates and a very active private banking sector. An index of 4 indicates that a country is around the level of BIS standards. Only Hungary had reached that level. For the rest, Romania and to a lesser degree Slovakia appear the least advanced. One even sees a temporary decline for the Romanian index. Romanian banks have had a history of soft budget constraints throughout the nineties (see Perotti and Carrara, 1996) and have been comparatively slow and not very successful in implementing banking reforms. Figure 7 does not include data beyond 1999 but casual evidence from various countries, including EU reports about preparation for accession suggest that there has been further improvement in the following years.

Figure 7: EBRD index of banking sector reform

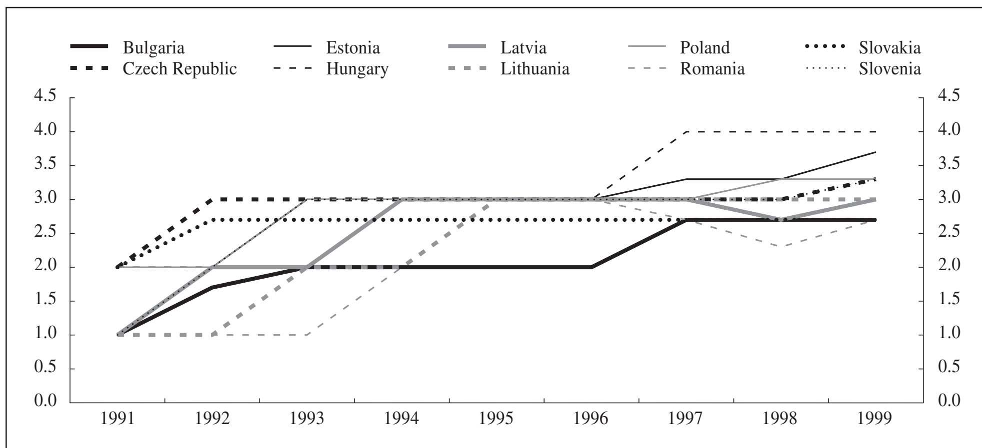
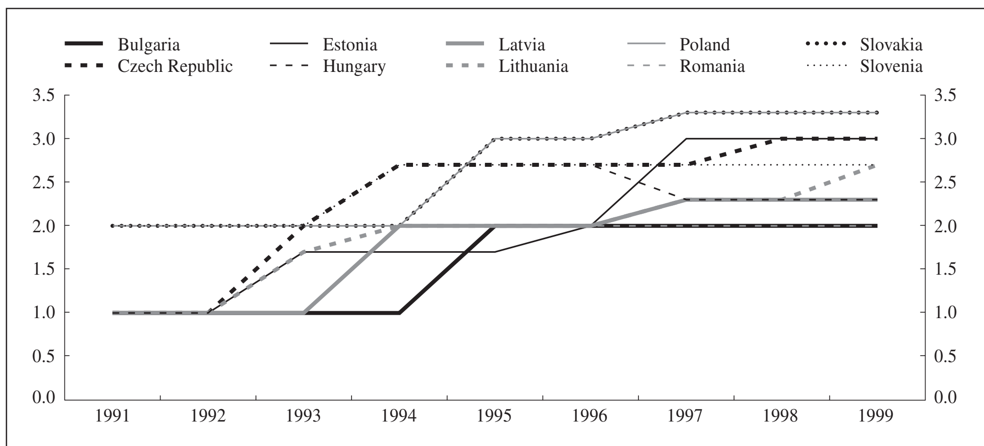


Figure 8 shows the evolution of reform of other financial institutions. This is mainly about securities markets. The picture here is more varied than with banking reform. Bulgaria is at the bottom and Hungary and Poland clearly on top. There are less signs of convergence. These reforms are very important complementary reforms to other reforms as they have an influence on market liquidity. Lack of experience with financial markets leaves small investors often unprotected and the lack of clear and transparent regulations can have a very negative influence on stock market liquidity. The slower progress with reform in this sector seems however to be of second order effect in these emerging market economies relative to other more substantial reforms such as the encouragement of the development of small and medium private enterprise sector.

Figure 8: EBRD index of reform of non-banking financial institutions



Overall, the picture emerging from the figures on reform is that most of them are really behind us. Only enterprise reform remains unachieved to a certain extent but there is no indication of reversal to past socialist practices.

Of course, it is difficult to assess the quality and the solidity of the institutions that have been established in the transition economies based only on these very broad indices. Measurement in this area is very difficult and often sketchy and the only viable option we have is to come up with as many institutional indicators as possible. The next few figures show more general indicators of the quality of institutions which should also be taken with caution. Figure 9 shows the Transparency International index of corruption for the New Member States. We present the evolution of the index until 2002. Here we see large variation. Slovenia and Estonia ranked the best among new Member States, respectively number 27 and 29 in 2002 just behind France. Romania ranked the lowest and was number 77 in the world together with Pakistan and the Philippines. One should not take variations in that index too seriously. Nevertheless, it is quite striking when looking at this figure that there is no clear upward trend in the index for the New Member States. The indices for the Czech Republic, Poland and Romania have even been going down. Only Bulgaria seems to have improved significantly. Corruption is thus definitely a factor to be looking at. Corruption took often different forms under central planning but in many countries, much of the corruption perceived in recent years is transition-related. There is no good explanation for this

phenomenon but it seems obvious that the transition process which is a unique historical process with thus unique opportunities as for example large scale privatization of state-owned assets has led many agents to seize the opportunities for corruption.

Figure 9: Transparency International-Corruption Perception index

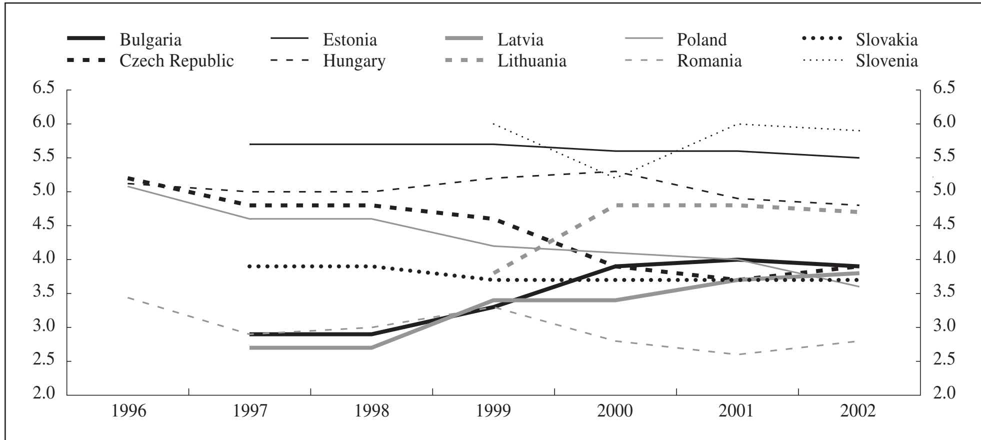
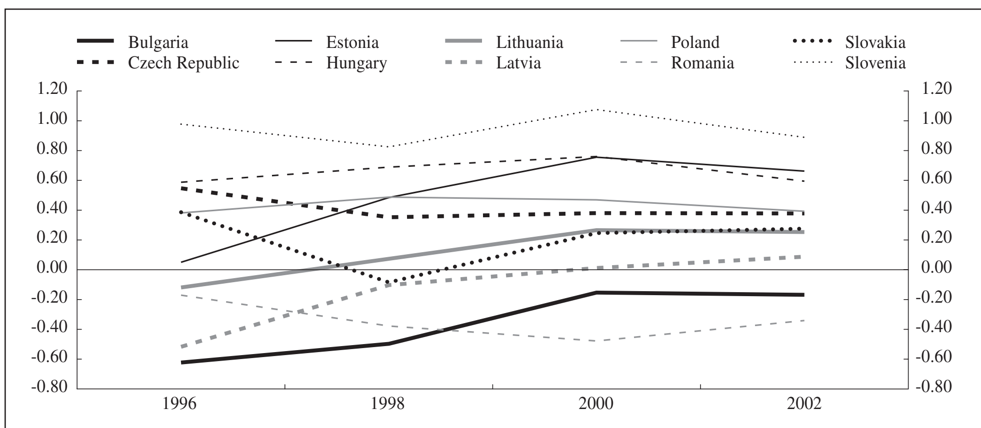


Figure 10 shows the World Bank index for control of corruption. Obviously, it is constructed differently than the TI index and addresses a slightly different question. It looks more encouraging. Nevertheless, one also sees a strong variation in the data. Slovenia and Estonia have been doing well. There are still a few countries where the index declines, Romania notably which is also performing the worst, but also the Czech Republic, Slovakia, Hungary and Poland all to varying degrees. Again, Bulgaria has improved.

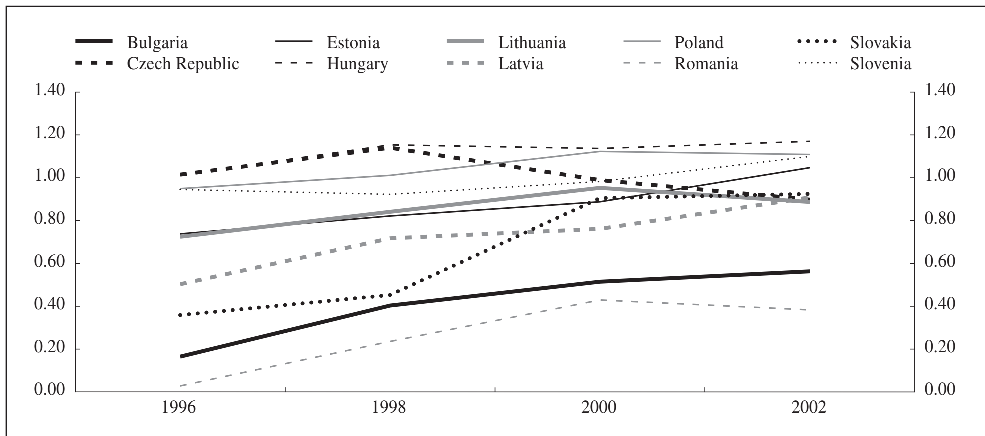
Figure 10: World Bank control of corruption



The World Bank voice and accountability index pictured in figure 11 is also encouraging. It is a composite index that reflects mostly surveys in different countries reflecting questions such as the amount of repression, the presence of political rights, the presence of the military

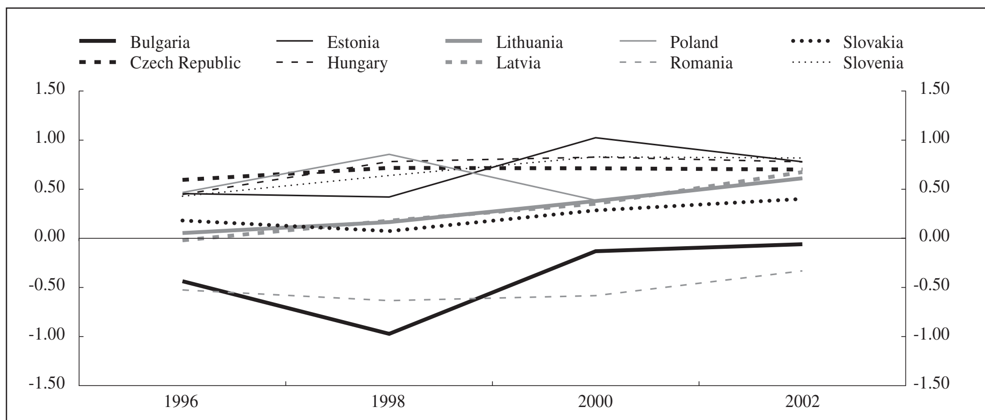
in politics, press freedom, fairness of elections, trust in government, transparency, accountability of public officials and a whole battery of indicators. This index shows progress for all countries except for the Czech Republic which goes through a concerning decline after a very good start. Romania and Bulgaria are behind while Hungary, Poland and Slovenia are on top.

Figure 11: World Bank voice and accountability



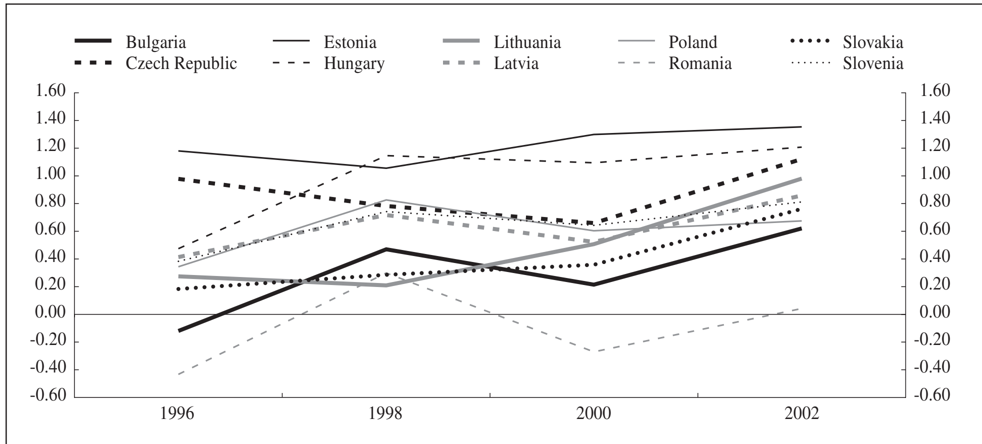
The picture is a bit different when we look at the World Bank Government effectiveness index, exhibited in figure 12. This index reflects surveys about the quality of the civil service, government instability, trust in the police and public officials. We see two distinct groups with Romania and Bulgaria lower than all the others. The general picture is nevertheless one of slow progress. Poland had a decline in the index in 1998 and Estonia in 2000.

Figure 12: World Bank Government effectiveness



The World Bank index for regulatory quality shows a larger variation across countries as can be seen from figure 13. Romania is the laggard while Estonia, Hungary and Czech Republic are on top. One observes a general increase especially since 2000.

Figure 13: World Bank regulatory quality



One should be cautious when drawing conclusions from figures 11 to 13 since they show only a limited window into the institutional evolution of the New Member States. However, the combination of the figures on the dynamics of reform and these more recent institutional data suggest a positive picture of the achievements of institutional reform in the new Member States. Corruption is the only worrying phenomenon.

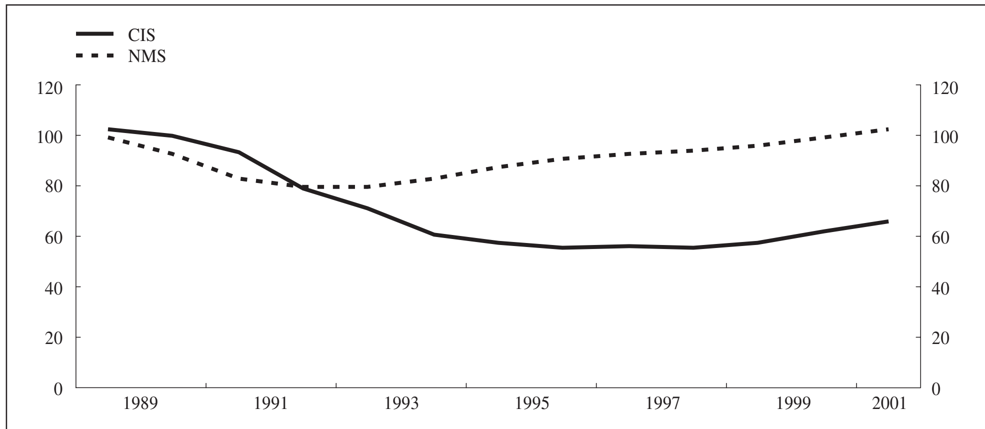
This general trend obtains despite substantial differences in the transition processes themselves. Countries like Hungary and Slovenia were more following a gradualist strategy whereas countries like the Czech Republic and Estonia, and Poland in the beginning, were trying to follow a Big Bang strategy of fast and simultaneous implementation of reforms. Some countries implemented a mass privatization program, most notably the Czech Republic, while most of the others used a combination of sales methods to gradually divest the state assets. Some countries like Poland implemented a stabilization program early in the transition while others did not face large disequilibria in the beginning of transition or dealt with milder macro stabilization problems later on. While the different strategies and policies certainly had different effects in different countries, the overall result is one of successful transition.

To conclude this section, the new Member States have definitely a positive record in achieving the post-socialist transition and of reforming their institutions towards better governance. The slow process of enterprise restructuring is not over though and will continue for some years. One must also be particularly attentive to vigorously rein in corruption.

3 The role of the EU as an institutional anchor

The achievements of the New Member States should be put in perspective. From that point of view, transition countries from the New Member States have experienced better outcomes than the CIS. Indeed, a “great Divide” (Berglöf-Bolton, 2002) has occurred between those two groups of countries. Figure 14 shows GNP developments in the two groups of countries.

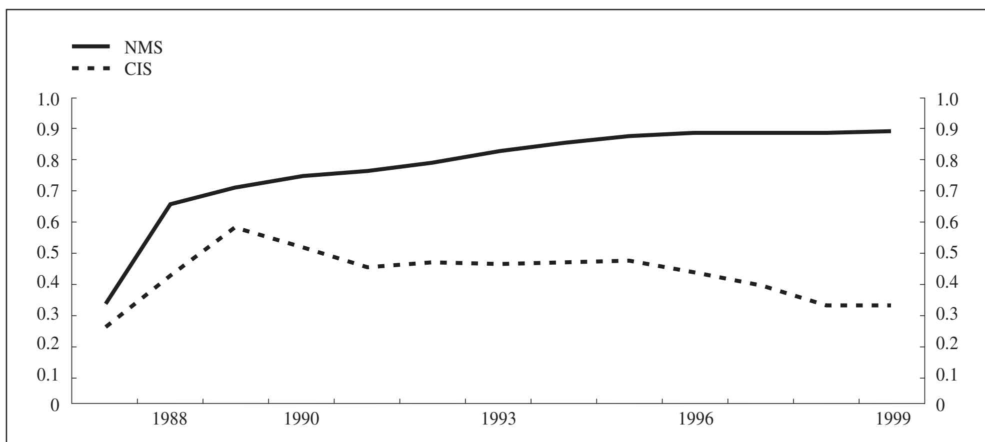
Figure 14: GNP index (1988=100)



One sees clearly from figure 14 that while output fell everywhere in the beginning of the transition process following price liberalization (on that see Blanchard and Kremer, 1997; Roland and Verdier, 1999), the output fall was less severe and less prolonged in the New Member States than in the CIS. Moreover, it has more or less returned to its pre-transition level whereas in the CIS, it is still over 30% below its pre-transition levels.

The great divide is not only economic. It is also deeply institutional. Figure 15 shows the striking difference in the freedom house index of civil and political rights of the two groups of countries. While the New Member States have clearly had a stable transition to democracy, the democratization process in the CIS is much less impressive and has even declined after an early start. Note that the decline already started early in the nineties.

Figure 15: Human rights (freedom house)



How can one explain this "Great Divide"? The differences in transition policies between the two groups of countries have not been that different. Truly, a great number of former Soviet republics have been reluctant, slow and late to reform but if one compares Russia with

the New Member States the differences in policy are not striking. All countries have had price liberalization early on in the reform process, all have been engaged in large-scale privatization policies and in restructuring programs. Russia implemented mass privatization which proved rather disastrous compared to countries like Hungary or Poland who did not. However, the Czech Republic also had a mass privatization program. Stabilization policy was less successful and late in Russia compared to Poland for example but Hungary also stabilized rather late and the Czech Republic also faced a stabilization problem in the late nineties.

Given that the policies were not so different, other explanations have been suggested. Sometimes one hears that cultural differences might play a role. Little research has been done to substantiate such claims but it is not a priori obvious why differences say between orthodox and Catholic-protestant religions should make such a large difference. Greece, a long time EU member is for example mostly orthodox. Still other explanations for the "Great Divide" include the longer period of communism in the Former Soviet Union (70 years against 40), differences in natural resource endowments and "distance from Brussels" which can be interpreted in many different ways. None of these explanations gives a straightforward answer to the question of why the New Member States have been faring better than the CIS.

A rather convincing idea is to explain these differences by the role of "external anchor" of the European Union, an idea first formulated by Berglöf and Roland in 1997 and formalized in Roland and Verdier (2003). To put it in a broader perspective, there are two components to the external anchor idea. A first one is geopolitical. It relates to the aspiration that citizens in satellite countries of the Soviet Union had to break away from their Soviet satellite status and to become a member of the "Western" club in Europe, and thus a member of the EU. This geopolitical motivation having at stake a change in the status of the Central European and Baltic countries gave stronger incentives to undergo reforms and may explain why the political constraints to reform where less strong in these countries relative to the CIS (Roland, 1997). The second component is related to the incentives associated to entry into the European Union itself. Membership required conditions to be fulfilled and a failure to satisfy the conditions set by the EU could lead to rejection or delayed entry. This gave very strong incentives to fulfill all conditions necessary to gain acceptance into the EU. These incentives can be compared to the effect created by the Maastricht criteria on candidates to the EMU. As we know, several countries including Italy and Belgium have had serious fiscal imbalances, and the prospect of EMU entry gave them strong incentives to improve their public finance situation.

The strong stabilization of democracy in the New Member States, as can be seen from figure 15 seems to me clearly an area where the role of external anchor of the EU has played an especially useful role. One should remember that the enlargement to Spain, Portugal and Greece happened after the demise of dictatorial regimes in those countries and that entry in the EU helped definitely stabilize democracy in those countries. Aspirations for democracy were immense prior to the collapse of communism but nationalist aspirations were equally strong and they might have produced clashes say between Hungary and Romania or between Hungary and Slovakia to name only a few examples. Such tensions might have had a very adverse effect on the democratization process as one has indeed seen in former Yugoslavia. It is always difficult to make counterfactual evaluations but it is fair to say that the prospect of EU accession has helped avoid and discourage Yugoslav type situations.

As stated in the introduction of this article, the incentives provided by the EU are the strongest when the reward is entry into the EU. Once inside, incentives to fulfill whatever conditions imposed by the Commission will generally be less strong. One sees this very clearly with the weak implementation of the Growth and Stability Pact. The issue has less to

do with how good an instrument it is. The real issue is that the EU does not have very strong enforcement powers towards the governments of Member States. This problem will appear in other dimensions of EU law enforcement within the enlarged EU with the new Member States. This is a reality we have to face. This would be very worrying if the New Member States had strong structural weaknesses that have not been addressed so far with the reform process. In that case, the EU might have a serious problem with enforcing change. However, as we have seen, the institutions of the New Member States appear quite in order. Therefore, despite the weak enforcement powers of the EU, we should not expect big problems ahead.

The institutional stabilization in the New Member States was the result of great efforts in the countries concerned but the EU has also played a very active monitoring role. In preparation for the accession, the European Commission has been following the progress of implementation of the *acquis communautaire*, i.e. the body of law that implements EU law in Member States. The Commission has been following the progress of Member States on 29 chapters: the four freedoms (free movement of goods, services, persons and capital), Company Law, Competition, Agriculture, Fisheries, Transport, Taxation, EMU, Statistics, Social Policy, Energy, Industry, Small and Medium Enterprises, Science and Research, Education and Training, Telecommunications, Cultural and Audiovisual matters, Regional Policy, Environment, Consumer and Health Protection, Customs Union, External Relations, CFSP, Financial Control, Financial and Budgetary Provisions and Institutions.

This process is a more bureaucratic one than the adoption of the big transition reforms and is certainly less inspiring. Nevertheless, I argue that it has worked as a simple and effective instrument to monitor the institutional evolution in the New Member States.

Figure 16: Implementation of the acquis

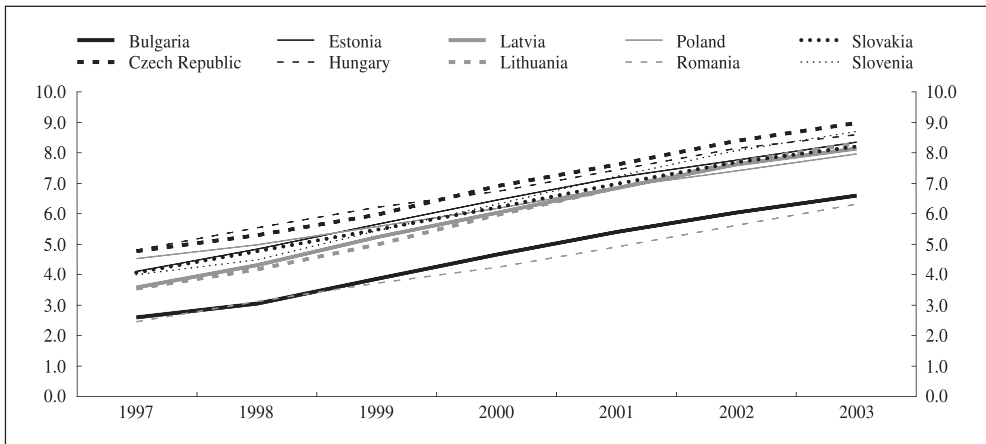


Figure 16 shows the average evolution of scores for all 29 chapters between 1997 and 2003. A score of 10 means a total implementation. The progress has been remarkably steady for all countries. Bulgaria and Romania who have not yet entered are the clear laggards and were probably given less attention, being perceived as the weaker accession candidates from the start. The Czech Republic, Slovenia and Hungary rank on top. Note that Poland performs the worst among the entrants despite a very good start.

The appendix gives the detail of the evolution for each of the 29 chapters. We only comment briefly on the various countries.

The Czech Republic has generally done the best in nearly all chapters. Hungary and Slovenia have done nearly as well. Bulgaria and Romania (mostly the latter) tend to be the laggards. Poland was top in taxation and Common Security and Foreign Policy (CSFP), Lithuania was on top for the environment and Latvia and Slovakia for Cultural and Audiovisual matters. Poland has been lagging for the four freedoms except for the free movement of persons. Also lagging were Estonia as well as Latvia on free movement of persons, the latter also lagging on telecommunications and customs union, and Slovakia lagging on free movement of services, competition and financial and budgetary provision.

It is interesting to note that countries have generally been reacting positively to progress reports emphasizing their weak points. The progress was then evaluated in the regular progress reports on accession that checked the various items in the implementation of the *acquis*. Let us take a few examples.

Bulgaria was criticized for slow progress in Transport, Taxation and Energy Policy. Subsequent reports evaluate the progress made and call for further progress. Progress in transport was later deemed “substantial”, “significant” in taxation and “encouraging” in energy.

Similar points have been made for the Czech Republic for the free movement of persons, telecommunications, Culture and Audiovisual and taxation. Taxation was a particularly bad point in 2001. The progress report noted divergence from the *acquis* in the VAT system. The 2003 noted with satisfaction that the problem had been corrected.

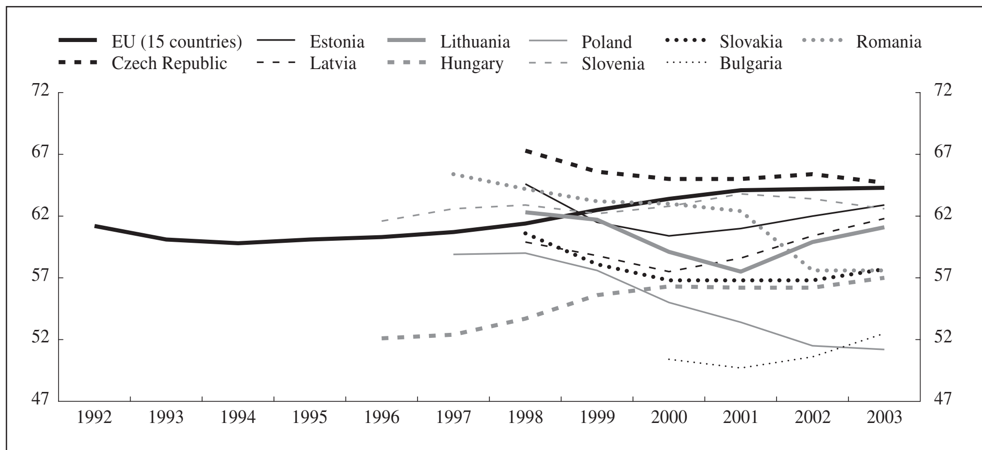
Estonia was similarly criticized on Culture and Transport, Hungary on taxation, EMU, Environment and Culture, Latvia on EMU and Social Policy, Lithuania on Free movement of persons and Consumer and Health Protection, Poland and Slovakia on culture and agriculture and Slovenia on taxation, competition, telecommunications, EMU and culture.

All in all, the monitoring of the progress by the EU in its own doggedly bureaucratic way has been relatively effective. The incentive effects (the reward of entry) probably played a more important role than the EU’s monitoring power but this monitoring was still quite thorough. It is interesting to note that Poland, despite being the first to start reforms and being the largest entrant, has been doing the least well of the new Member States. I interpret this less as having to do with reform failures than with a “big country” attitude whereby one is more used to thinking how to influence the EU rather than how to follow its decisions. There is nevertheless no large difference between the implementation of the *acquis* in Poland and in the other New Member States.

4 Can we learn from the New Member States about the structural reforms needed in Europe?

In 1999, Poland introduced a three tier pension system with a pay as you go component, a fully funded mandatory contribution component and a voluntary component. Newspaper articles in the press lauded the new system noting that Poland, having undergone major transition reforms, was being faster than most existing EU members in reforming its pension system. Are the new Member States being the leaders in pension reform? Similarly, given the absence of independent trade unions under communism, with the exception of Poland, the New Member States have not had very strong Unions. Have their labor markets that were liberalized with transition become more flexible than those inside the EU? One sometimes hears that transition countries have been injected with more liberalism than existing EU members. What is the reality?

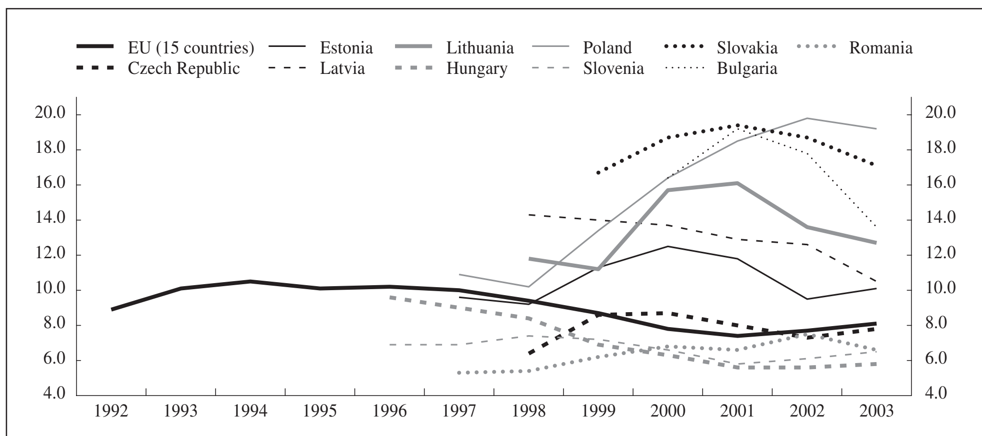
Figure 17: Total employment rate



Let us first start with labor market reform. Figure 17 shows the employment rate in the EU 15 and in the New Member States. We see immediately that the employment rate is in general lower than in the EU15 and tends to be declining while it is not in the EU15. Bulgaria has the lowest but is improving. Poland's employment rate is dangerously decreasing. So is the case with Romania. The picture looks thus worse in the New Member States than in the EU! This is probably one of the least well noticed features of transition countries. Many people who lost their job during the transition dropped out of the labor market altogether. Moreover, the low number of jobs created has had a negative effect on labor supply. This is truly a transition phenomenon as employment rates prior to transition were much higher than in the EU (Boeri, 2000). It reflects the restructuring process that has been taking place since the early nineties but that is not nearly over, as we mentioned above.

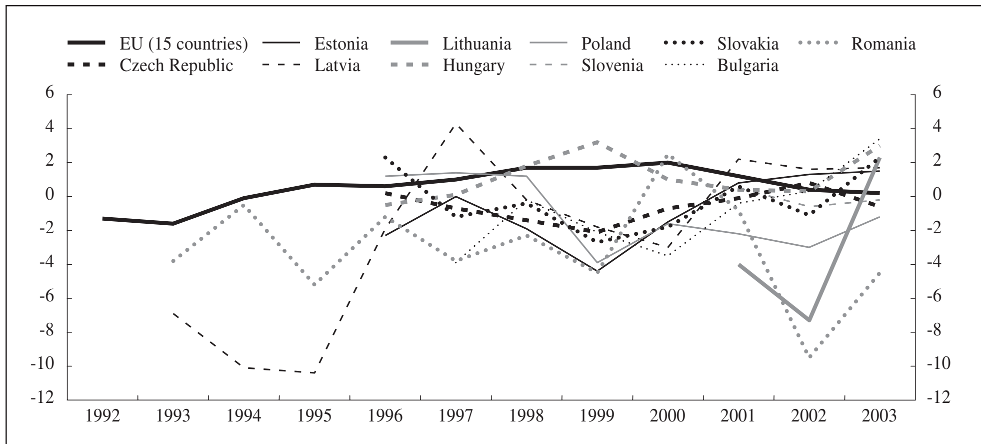
Figure 18 shows the unemployment rates. One sees that they are usually higher than in the EU15 with the exception of Hungary, Slovenia, Romania and Czech Republic. One notices

Figure 18: Total unemployment rate



very high unemployment rates in Poland, Bulgaria and the Baltics. This is not too surprising given the restructuring activity in those countries. Nevertheless, these first figures do not give the impression of thriving labor markets. On the contrary, they tend to suggest that the situation in the new Member States is worse than in the EU15. Is this compensated by a higher rate of job creation? Figure 19 displays employment growth. One sees strong year by year variability but no particular pattern of higher average growth in the new Member States.

Figure 19: Total employment growth



When one looks at implementation of labor market reforms in individual countries, nothing really revolutionary can be noted. Most of the legal changes in that field can be interpreted as copying laws from existing EU countries: mostly active labor market programs and measures to create more labor market flexibility. There is a lot of evidence of rigidities at the level of different countries. In the Czech Republic for example, despite rather flexible labor market regulations, the housing market is very rigid and generalized rent controls prevent good mobility across regions. Boeri (1994) had written about the "stagnant" labor market pool and Boeri (2000) noted the strong rigidities on labor markets in Central Europe.

Note that the correlation between high unemployment rates and labor market rigidities is not automatically clear. Slovenia has a very corporatist system and has managed to maintain low unemployment rates. Romania seems also to be doing quite well here.

Table 1 gives an index of rigidity of labor market laws in the EU15 and in the New Member states. The right hand column ranks the countries from less rigid to more rigid. While no country does as badly as Spain or Portugal, it is clear that labor market rigidity is higher in the New Member States than in the EU15. Note however that the Czech Republic scores relatively well and ranks number 4 in Europe behind Denmark, the UK and Austria. All in all, most New Member States will have to participate in labor market reforms just like most of the other EU countries.

Figure 20 shows general social benefits as a percentage of GDP. The figure shows a generally lower share of expenditures on social programs compared to the EU with the notable exception of Poland. There is thus not really a social time bomb in the New Member States. On the other hand, the latter are also poorer and it is not surprising to see lower social generosity in poorer countries.

Table 1

Employment laws index (0=less rigid to 100=very rigid)		Employment laws index (0=less rigid to 100=very rigid)	
EU Accession Countries (current and future)		Ranked	
Bulgaria	53	Denmark	25
Czech Republic	36	United Kingdom	28
Estonia	–	Austria	30
Hungary	54	Czech Republic	36
Latvia	62	Sweden	42
Lithuania	64	Belgium	48
Poland	55	Ireland	49
Romania	54	France	50
Slovakia	61	Germany	51
Slovenia	59	Bulgaria	53
EU-15		Hungary	54
		Romania	54
Austria	30	Netherlands	54
Belgium	48	Poland	55
Denmark	25	Finland	55
Finland	55	Slovenia	59
France	50	Italy	59
Germany	51	Slovakia	61
Greece	67	Latvia	62
Ireland	49	Lithuania	64
Italy	59	Greece	67
Luxembourg	–	Spain	70
Netherlands	54	Portugal	79
Portugal	79	Estonia	–
Spain	70	Luxembourg	–
Sweden	42		
United Kingdom	28		

Figure 20: Social benefits (other than social transfers in kind) paid by general government *(% of GDP)*

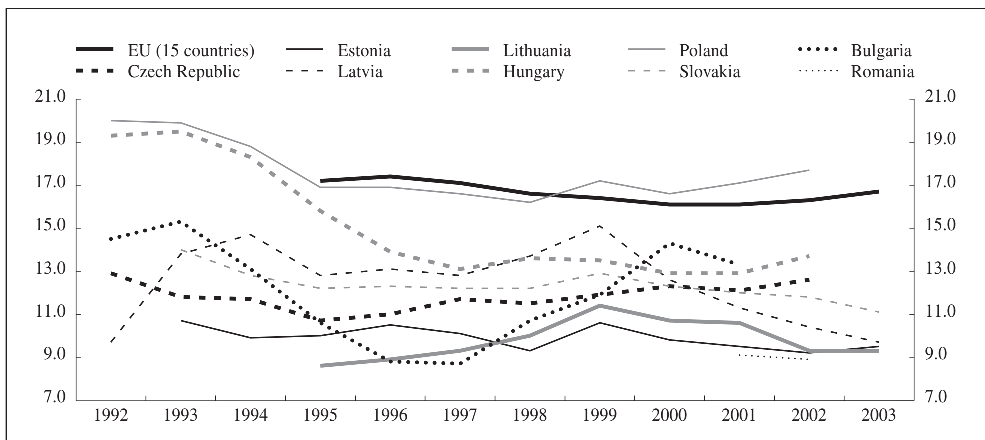


Table 2 shows contribution rates for social security. These rates are generally high but not necessarily among the highest (Romania is the highest though!). They are however nowhere nearly as low as the figures of Ireland and UK. Note also that Poland and Hungary have higher contribution rates than Germany.

Table 2: Contribution rates for social security programs, 2002
(in percent)

	Old age, disability, survivors			All social security programs [1]		
Country	Insured person	Employer	Total	Insured person	Employer	Total
Austria [4]	10.25	12.55	22.75	17.20	25.10	42.30
Belgium	7.50	8.86	16.36	13.07	24.87	37.94
Bulgaria	22.25	8.75	31.00	25.50	19.20	44.7 [3]
Czech Republic	6.50	19.50	26.00	12.50	35.00	37.5 [3]
Denmark [4]	[6]	[6]	[6]	[6]	[6]	[3), 6]
Estonia	0.00	20.00	20.00	0.00	33.00	33 [3), 7]
Finland [4]	4.40	16.70	21.10	6.30	20.40	26.7 [3), 7]
France [4]	6.65	9.80	16.45	15.45	33.86	49.31
Germany [4]	9.55	9.55	19.10	19.80	21.11	40.91 [3]
Greece [4]	6.67	13.33	20.00	11.95	23.90	35.85
Hungary [4]	8 [2]	18 [2]	26 [2]	12.50	32.00	44.50
Ireland	6 [2), 9]	10.75 [2), 9]	16.75 [2), 9]	6 [9]	11 [9]	17 [3), 9]
Italy [4]	8.89	23.81	32.70	8.89	32.22	41.11
Latvia	[10]	[10]	30.86	9.00	26.09	35.09 [3]
Lithuania	2.50	22.50	25.00	3.00	28.00	31 [3]
Luxembourg [4]	8.00	8.00	16.00	15.40	13.57	28.97 [3]
Netherlands [4]	19.15	8.90	28.05	36.05	18.75	54.8 [3]
Poland	16.26	16.26	32.52	26.46	20.88	47.34 [3]
Portugal	11 [2]	23.75 [2]	34.75 [2]	11.00	26.75	37.75
Romania [4]	11.66 [2]	23.34 [2]	35 [2]	19.66	35.34	55 [3]
Slovakia [4]	6.4 [2]	21.6 [2]	28 [2]	12.80	38.00	50.8 [3]
Slovenia	15.5 [2]	8.85 [2]	24.35 [2]	22.10	15.90	38 [3]
Spain [4]	4.7 [2]	23.6 [2]	28.3 [2]	6.25	31.58	37.83
Sweden [4]	7.00	10.21	17.21	7.00	19.09	26.09 [3]
United Kingdom [4]	10 [2]	11.9 [2]	21.9 [2]	10.00	11.90	21.9 [3]

Source: http://www.ssa.gov/policy/docs/progdesc/ssptw/2002-2003/europe/guide.html
1) Includes old age, disability, and survivors; sickness and maternity; work injury; unemployment; and family allowances. In some countries, the rate may not cover all of these programs. In some cases, only certain groups, such as wage earners, are represented. When the contribution rate varies, either the average or the lowest rate in the range is used.
2) Also includes the contribution rate for other programs.
3) Government pays the total cost of family allowances.
4) Contributions are submitted to a ceiling for some benefits.
5) New system rates.
6) Portion of set amount for old age, disability, and survivors. Central and local government and other types of contributions for the other programs.
7) Government pays the total cost of basic unemployment benefit.
8) Government pays the total cost of cash sickness and medical benefits.
9) Range according to earnings bracket. Higher rate is shown, which applies to highest earnings class.
10) See total.

Table 3 gives relevant data about social security. New Member States have relatively younger populations than the EU15 so they face a less important demographic problem but one should not exaggerate the difference. On the other hand, the dependency ratios in the new Member States are not among the highest but they are not really low either. The pension ages are in line with those from the EU15 though they are rather generous. Slovenia has the earliest retirement age for men at 58. One should note that the retirement age tended to be considerably lower early in transition and reforms have already taken place in the nineties to increase the pension age. Table 4 gives a broad overview of the different types of pension systems in Europe.

Table 3: Demographic and other statistics related to social security, 2002

Country	Total population (millions)	Percentage 65 or older	Dependency ratio [1]	Life expectancy at birth		Statutory pensionable age		Early pensionable age [2]		GDP per capita ($U.S.)
				Men	Women	Men	Women	Men	Women	
Austria	8.1	15.4	47.7	74.7	80.9	65.0	60.0	61.5	56.5	25,089
Belgium	10.2	16.8	52.2	75.0	81.3	65.0	62.0	60.0	60.0	25,443
Bulgaria	8.0	16.0	47.4	67.1	74.8	61.5	56.5	[3]	[3]	5,071
Czech Republic	10.3	13.7	43.8	71.2	78.0	61.0	59.0	58.0	56.0	13,018
Denmark	5.3	15.0	49.4	73.6	78.6	67.0	67.0	60.0	60.0	25,869
Estonia	1.4	14.1	47.9	64.8	75.8	63.0	58.0	[3]	[3]	8,355
Finland	5.2	14.8	49.4	73.7	81.0	65.0	65.0	60.0	60.0	23,096
France	59.0	15.8	53.1	74.5	82.3	60.0	60.0	[3]	[3]	22,897
Germany	82.0	16.1	46.8	74.3	80.6	65.0	65.0	[3]	[3]	23,742
Greece	10.6	17.2	48.1	75.5	80.8	65.0	65.0	60.0	60.0	15,414
Hungary	10.0	14.6	46.6	66.8	75.4	62.0	62.0	[3]	[3]	11,430
Ireland	3.8	11.3	49.9	73.8	79.1	66.0	66.0	[3]	[3]	25,918
Italy	57.5	17.8	47.4	81.6	75.2	65.0	60.0	[3]	[3]	22,172
Latvia	2.4	14.5	48.3	64.3	75.6	61.5	58.5	60.0	56.5	6,264
Lithuania	3.7	13.1	49.4	66.5	77.0	62.0	58.0	[3]	[3]	6,656
Luxembourg	0.4	14.3	49.2	73.9	80.4	65.0	65.0	57.0	57.0	42,769
Netherlands	15.8	13.6	47.0	75.3	80.7	65.0	65.0	[3]	[3]	24,215
Poland	38.6	11.9	46.6	69.0	77.3	65.0	60.0	[3]	[3]	8,450
Portugal	10.0	15.4	47.4	71.9	79.1	65.0	65.0	55.0	55.0	16,064
Romania	22.5	13.1	46.6	66.5	73.3	65.0	60.0	55.0	55.0	6,041
Slovak Republic	5.4	11.3	45.7	69.1	77.0	60.0	60.0	[3]	[3]	10,591
Slovenia	2.0	13.6	42.8	71.5	78.9	58.0	54.0	[3]	[3]	15,977
Spain	39.9	16.7	46.4	74.8	81.9	65.0	65.0	61.0	61.0	18,079
Sweden	8.9	17.4	56.0	77.0	82.1	65.0	65.0	60.0	60.0	22,636
United Kingdom	59.3	15.7	53.3	75.0	80.0	65.0	60.0	[3]	[3]	22,093

1) No country in Europe has provident funds. The column is in this table to facilitate comparisons with countries in other regions.
2) The benefit formula contains a flat-rate component as well as an earnings-related element.
3) Persons who became insured before June 30, 1998, or who became insured after this date but before reaching the age of 42 years, can choose between the earnings-related system or the mixed system of the earnings-related pension and private insurance.

Table 4: Types of mandatory systems for retirement income

Country	Flat-rate	Earnings-related	Means-tested	Flat-rate universal	Provident funds [1)]	Occupational retirement schemes	Individual retirement schemes
Austria		X					
Belgium		X	X				
Bulgaria		X	X				X
Czech Republic	X [2)]	X [2)]					
Denmark			X				X
Estonia	X [2)]	X [2)]					X
Finland			X			X	
France		X	X			X	
Germany		X					
Greece		X					
Hungary		X					X [3)]
Ireland	X		X				
Italy		X	X				
Latvia		X	X				X
Lithuania	X [2)]	X [2)]					
Luxembourg	X [2)]	X [2)]					
Netherlands	X						
Poland	X [2)]	X [2), 4)]					X [4)]
Portugal		X	X				
Romania		X					
Slovak Republic		X	X				
Slovenia		X					
Spain		X					
Sweden		X	X				X
United Kingdom	X	X	X				

1) No country in Europe has provident funds. The column is in this table to facilitate comparisons with countries in other regions.
2) The benefit formula contains a flat-rate component as well as an earnings-related element.
3) Persons who became insured before June 30, 1998, or who became insured after this date but before reaching the age of 42 years, can choose between the earnings-related system or the mixed system of the earnings-related pension and private insurance.
4) The old system contains a flat-rate component as well as an earnings-related element. The new system includes an earnings-related notional defined contribution (NDC) scheme and private mandatory insurance.
Note: Flat-rate pension: A pension of uniform amount or based on years of service or residence but independent of earnings. It is financed by payroll tax contributions from employees, employers, or both.

One should note that most of the new Member States have undertaken serious measures to introduce a three tier pension system, which seems to be the model that will generally prevail throughout Europe as radical privatization of pension systems is generally rejected by the population (Boeri, Tabellini and Boersch-Suppan, 2001).

All in all, there is no big difference between the state of pension systems in the new Member States and that in the EU15. High contribution rates and low pension ages indicate that further efforts in pension reform will be needed in the New Member States.

To conclude this section, there is no large difference in the need for structural reforms in the New Member States. The latter tend to have very rigid labor markets with the partial exception of the Czech Republic and they will have to make sure that their social welfare and pension systems are sustainable in the long run.

5 What can we expect from a Europe of 25 and what will be the contribution of the New Member States?

Several years ago, EU observers noted that there was a contradiction between deepening and widening. Deeper integration meant remaining together in a smaller club and widening meant forsaking further gains in integration. Both advocates and enemies of enlargement claimed that with enlargement Europe would be diluted to little more than a free trade zone. Indeed, in a Europe of 25, decision-making would be much more difficult given the high thresholds for qualified majority that were not addressed satisfactorily by the Nice Treaty. Advocates of looser integration saw this as a plus while the advocates of deeper integration saw this as a threat to further future integration. In reality, it seems that we are going to have both widening and deepening. Less than two months after the historical enlargement, the European Council approved with some modifications the project for the European Constitution prepared by the Convention in 2003. The Constitution represents a marked improvement on the Nice Treaty. The qualified majority voting rule for legislation initiated by the Commission will be 55% of Member States (at least 15 states) and 65% of the population (article I-24), a lower threshold than Nice. The European Council will elect its president for a period of 2.5 years and the Commission president will be elected by the European Parliament after the elections to the latter, upon a proposal from the European Council. Co-decision will be the rule for legislative decision-making giving more powers to the European Parliament. Europe will also have a foreign minister. Legislative procedures and categories will be simplified. If the Constitution is ratified, it will provide a solid basis for decision-making within an enlarged Europe. Indeed, it strikes a fine balance between the preservation of national sovereignty and the creation of options for further integration in a larger Europe. On the one hand, the catalogue of competences and the extent of qualified majority voting has not been extended in the Constitution. On the other hand, it does leave an option for further consensual integration: after the initial ratification of the Constitution by the Member States, further ratifications will not be necessary for extensions of the domain of qualified majority voting and changes in the catalogue of competences in areas because of special flexibility clauses included in the Constitution (articles I-17 and IV-7a) that allow the European Council to make such changes using the unanimity rule.[2] Moreover, the rule for qualified majority makes decision-making easier in domains where countries have already agreed to transfer sovereignty to the European Union.

Note that the Central European participants to the Convention have helped to contribute to its success. They came as enthusiastic conventioneers participating with the spirit of contributing to the preparation of the best possible Constitution for Europe. They had less vested interests to defend and could take at heart the larger and longer term interests of Europe.

While there is strong enthusiasm for European integration, the low election turnouts in various new Member States indicates that the population of those countries has yet to become more familiar with the European institutions. The media from those countries will have an important responsibility there.

Note that the support for Europe in the New Member States does not come from those categories of the population that hope to gain from European subsidies but rather for other categories who are likely to benefit from the Single Market (Doyle and Fidrmuc, 2004).

[2] Moreover, following the subsidiarity principle, national parliaments will need to be consulted on changes in the catalogue of competences.

6 Concluding remarks

We asked several questions in the introduction.

Can we say that the New Member States have achieved their institutional transition in a stable and satisfactory way? The answer is yes. The New Member States may face institutional problems in the future but they are not worse than those facing existing EU members. The only important legacy from transition is an unfinished enterprise restructuring process that will leave many sectors economically fragile for quite many years. Corruption will also need to be watched carefully.

Has the EU played a positive role in helping those countries achieve their transition? The answer is a clear yes. The prospect of entry in the EU has played the role of a powerful magnet for the transition process. Moreover, the EU has been able to use this magnet effectively to prepare the candidates for accession in implementing the *acquis communautaire*.

Third, given the experience of the new Member States with large scale reforms, is there anything that the EU can learn for its needed structural reforms in labor markets, pension and welfare reform? Here, the answer is disappointing. The structural reforms agenda outlaid since the Lisbon summit will be just as valid for the new Member States as for previous EU members. Structural reforms need to speed up in a Europe of 25.

Finally, how will the EU work with 25 and what will be the contribution of the New Member States? The answer to that question is obviously more speculative but both the success of the Constitutional Convention and the participation of delegates from those countries is a sign that their input will be interesting, loyal and original. I hope that historians will look back at the beginning of the twentieth century as the beginning of a new era for Europe that closed the cold war and represented a significant step forward in European integration and towards durable peace on the continent.

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