Not "Just Another Accession"

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Andrzej K. Koźmiński: I am honored to welcome everyone today to the lecture of Professor Domenico Mario Nuti, both in this conference hall as well as in all participating universities connected to this event, thanks to Internet technology. In the last couple of months our school was visited by quite a few distinguished economists. Today we will have another excellent opportunity to listen to one of the most well known experts on post-socialist transformations. Professor Nuti has known Poland for a long time. I still recall our meeting in the early 1960's, when Professor Nuti studied in our country. I believe, however, that Professor Grzegorz W. Kolodko is in a better position to introduce today's speaker. Professor Kołodko is the Director of the TIGER economic think–tank (Transformation, Integration and Globalization Economic Research), that is affiliated with our school. Professor Kołodko co-authored one book and various essays with Professor Nuti. He has also been collaborating with Professor Nuti on various economic issues dealing with transformation.

Grzegorz W. Kolodko: Let we warmly welcome everyone. Particularly, I would like to welcome Professor Nuti, our guest today and a long-time friend. As mentioned by Professor Koźmiński, Professor Nuti has known Poland for the last forty years. For your information, Professor Nuti also speaks fluent Polish thus, although the lecture will be delivered in English, the subsequent discussion can easily be conducted in Polish.

We were happy to invite Professor Nuti not only because of his distinguished background in economics but also because of his unique knowledge of the countries of Central and Eastern Europe (CEE). Professor Nuti is very well acquainted with the reality of CEE countries, which are now at different phases of their transformation to the market economy and integration with the European Union. Professor Nuti researched not only the post-socialist transformation but also processes pending in the CEE long before the transition period. He has also advised various international organizations, governments and presidents of many countries. I had the honor to collaborate with Professor Nuti when he was an advisor to Poland's Deputy Prime Minister and Minister of Finance in 1994-97. Professor Nuti also co-operated with political and economic leaders of less advanced transition countries like Belarus or Uzbekistan, countries not integrating with the EU.

Apart from dealing with various aspects of the transformation and integration process, Professor Nuti also worked as an expert and consultant to the EU. In doing so, however, he never really lost touch with Poland. He is so sensitive to Poland's situation that when in the beginning of the 1990's the erstwhile Polish negotiator of the association treaty with the EU spotted Professor Nuti in the negotiation room, he could not restrain himself from asking Professor Nuti which side he was working for.

Professor Nuti combines classical economics and the Western approach to integration with a thorough understanding of the Eastern attitude towards this process. This is truly a unique knowledge. Coupled with his background of theoretical and comparative studies, (Professor Nuti is now the President of the European Association for Comparative Economic Studies) his lecture today will undoubtedly be excellent.

Professor Nuti has a degree in Law from the University of Rome and a Ph.D. in Economics from Cambridge University. He was a director of the Centre for Russian and East-European Studies at the University of Birmingham. He advised practically all important international organizations, including the World Bank, OECD, the EU, FAO, IMF, ILO and even NATO, which then closely observed economic transformation in our part of the world and its political implications for the region. Above all, though, Professor Nuti is an academic professor and author of numerous publications. As mentioned by Rector Koźmiński, we both co-authored a publication „The Polish Alternative" published by the United Nations University World Institute for Development Economic Research. This publication has been subsequently translated and published in Russian, Chinese, and most importantly in Polish as „Polska alternatywa. Stare mity, twarde fakty i nowe strategie". The English version can be downloaded from the web-site of the TIGER think-tank at www.tiger.edu.pl

Before I give the floor to Professor Nuti, I would like to add that today's lecture is sponsored by BAT within a program of „incuBATor of Knowledge". Thanks to the „incuBATor" and the 'new economy' the lecture will be transmitted on-line to almost twenty universities all over Poland. Today's lecture is also a part of the Leon Koźmiński Academy of Entrepreneurship and Management (WSPiZ) Distinguished Lectures Series, which has so far featured Robert A. Mundell, 1999 Nobel Prize Laureate in Economics, and Vito Tanzi from the IMF. Seizing the opportunity I now have, I would also like to invite you to the next WSPiZ Distinguished Lecture on the 'The Asian Crisis – Four Years Later and Its Implications for Emerging Markets", which will be delivered by Professor Mario I. Blejer from the IMF.

Now finally, let me give the floor to Professor Nuti to deliver his lecture on „Not 'Just Another Accession'".

D. Mario Nuti: Let me welcome you all. Having listened to Professor Koźmiński and Kołodko I feel a bit like a honorary Pole. Thank you for the very warm welcome, introduction and invitation by the Rector, the Director of TIGER and the "incuBATor of Knowledge". I will not tire you with my Polish, because forty minutes of it would be too much for both you and me. I would, however, be happy to conduct the discussion after the lecture entirely in Polish.[1]

Ever since its inception in 1957 the European Community – now European Union – has undertaken a steady parallel process of deepening and enlargement. Progressively deeper degrees of integration have gone from sectoral cooperation in coal and steel to a Customs Union, then a Common Market further liberalized later to form the Single Market, then exchange rate coordination within the Exchange Rate Mechanism (ERM), followed by the rush towards monetary unification with the Euro as a single currency. At the same time four successive rounds of enlargement have brought European Union membership from six to fifteen. Therefore there is a

[1] Translated from original in Polish. The presentation is based on research undertaken within the ESRC programme "One Europe or Several?".

temptation to treat EU enlargement to the East as *"Just another accession*". This is actually how a high official of the European Commission – who should remain unnamed – labeled enlargement at a Brussels meeting in 1995. And even today there are still some observers and academics who regard the enlargement to the East as *deja vue*. In 1997 I co-authored a book provocatively entitled *'Not "Just Another Accession"'* [2]and in my lecture today I would like to update and develop the argument that the current round of enlargement is an unprecedented move, a radically and uniquely different process with respect to earlier rounds of accessions, with new, greater and far-reaching implications.

To summarise, the enlargement to the East currently under consideration is a slow-motion large-scale process, undertaken simultaneously with a slow-motion and drastic deepening of integration through a monetary unification which is doubly premature: because the area of the European Union is not yet an optimal currency area and because it is not preceded by the political unification which normally should accompany the establishment of a single currency. There are no other instances in history of a currency that is not backed by a state and a government.

These are not the only exceptional features of the current round of enlargement. The new accession candidates have not yet completed their systemic transformation to fully-fledged market economies: they are short on *institutional convergence*. They appear to be deceivingly close to meet the strict conditions for *monetary and fiscal convergence* as defined by the Maastricht Treaty but, as we shall see, there are other open and hidden problems, which are not taken into account by the standard Maastricht indicators. These countries moreover are nowhere near *real convergence* with the current members of the Union. And they are joining a far more integrated area than other accession candidates were joining in earlier rounds of enlargement. What are the implications of these unprecedented features of current enlargement?

I will argue that in these conditions both the advantages and the costs associated with greater economic integration are larger that they would be for more

[2] Eatwell John, Michael Ellman, Mats Karlsson, D. Mario Nuti and Judith Shapiro (1997), "Not 'Just Another Accession' – The political economy of European Union enlargement to the East", IPPR, London. By the same authors, see also "Transformation and Integration: Shaping the future of central Eastern Europe", IPPR, London 1995; "Hard Choices, Soft States: social welfare policy in the transition", IPPR, London 2000.

homogenous partners, as there is bound to be greater displacement of resource uses. There is a presumption of net advantages over time, but these are unlikely to be frontloaded; initially there are bound to some gross or even net losses. Even for a positive present value of net advantages, there will be losers as well as gainers. Gainers should be in a position to more than compensate losers; but *potential over-compensation*, as we know from economic theory, is not a sufficient test for an unambiguous improvement in social welfare. *Actual* re-distribution from gainers to losers must take place, on a scale sufficient to over-compensate losers. The large scale displacement in resource uses, the large scale losses and gains which derive from integration in the absence of greater homogeneity than experienced today by current and prospective Union members, will require transfers on a much greater scale than is contemplated at present: nationally, internationally and inter-temporally.

Following this kind of "executive summary" of my lecture, I will now go back and try to substantiate and develop these arguments.

I spoke of large scale, slow-motion enlargement. Accession candidates represent almost one third of the European Union population and territory; the fact that they produce less than 5 per cent of EU current income makes things harder, not easier. In the past, each round of enlargement had at most three new members; we now have ten central-eastern European candidates for accession, plus Cyprus and Malta, and there are other countries in the queue. There is Turkey, although negotiations have been delayed by political considerations and by the recent financial crisis; there is Croatia, which might in the end join and perhaps overtake some of the present candidates; Yugoslavia is lined up for negotiations, and there are other western-Balkan countries, as well as Ukraine, wishing to join the EU in a more distant future.

In the early 1990s the European Union was slow in responding to eastern European transition – apart from the instant and automatic East German accession by virtue of German re-unification. The Union first contemplated enlargement in principle only at the Copenhagen summit of June 1993. From the inception of transition in 1990 it took three and a half years for the Union to even imagine this possibility; by that time the announcement effect of this decision – still conditional and non-committal – was obviously lost. Then the Union was slow in opening negotiations. I remember that, when I had the pleasure of working with Professor

Kołodko in his capacity as Finance Minister, Brussels distributed to all eastern candidates a mass of questionnaires to be filled with great urgency, with all kinds of conceivable questions; the answers filled 30 thick and large volumes, in two versions both English and Polish. They provided a haphazard collection of unrelated pieces of information, which I cannot believe anybody in Brussels ever read let alone used. The volumes – in spite of the good and hard work of Polish officials – compare very poorly with the country reports routinely provided by the IMF and the World Bank. Such bureaucratic approach was one of the causes of avoidable delays in the path to enlargement.

The very choice of candidate countries was never the object of open discussion. First the European Commission decided what kind of agreements was going to be entered with various countries: Association Agreements with some, Partnership or Cooperation agreements with others. Then, in June 1993, it was decided that those countries with which the European Union had signed an Association Agreement should be treated as possible members, excluding all the others. There was never any open discussion in the European Parliament, or in the Council, of what kind of Agreement to negotiate with each country; the Brussels bureaucrats decided – indirectly – which countries would become accession candidates. Effectively the decision was taken by default.

Initially, there was a discussion as to whether accession countries should start negotiations and make progress if and when they were ready (the so-called “regatta” approach) or all at the same time (the so-called “big bang” approach). A compromise solution saw the emergence of two groups. The first wave, usually called the Luxembourg group since negotiations were opened in 1998 under the Luxembourg presidency, includes Estonia, the Czech Republic, Hungary, Poland and Slovenia plus Cyprus. The second wave, including Bulgaria, Latvia, Lithuania, Romania and Slovakia plus Malta, is usually called the Helsinki group because negotiations followed the 1999 Helsinki summit.

Gradually Latvia, Lithuania, Slovakia (and Cyprus) seemed to latch onto the first group, leaving behind only Bulgaria and Romania, until the Nice summit of December 2000 when a new grouping was established. Cyprus, Malta, Estonia, Hungary and Poland were placed in the first group of more advanced candidates. The Czech Republic and Slovenia were in a second group; with Lithuania, Latvia and

Slovakia in a third group and Bulgaria and Romania in a fourth group. We seem to have gone back to the "regatta" approach: whoever makes faster progress will be able to get in sooner.

More recently Poland has been slipping somewhat. Mr. Jan Kułakowski, Poland's chief EU accession negotiator, has a reputation for being tough. Poland is holding a hard line on sensitive issues such as land sales to foreigners, the movement of Polish workers, tax breaks to investors in its special economic zones, government bailout for the steel sector. But Poland remains in a very strong position, not only for its impressive achievements but also for its sheer size – 37 per cent of the population and 41 per cent of GDP of the eastern accession candidates. It is inconceivable that the enlargement could take place without Poland as a frontrunner.

Enlargement – I argued in my introduction - has been simultaneous with a slow motion, partial, premature monetary integration. It is slow motion because EMU membership requires at least two years compliance with the Exchange Rate Mechanism II, plus reaching and maintaining for a year the Maastricht parameters for public debt and deficit, for inflation and interest rates. It is slow motion also because it is partial, as it leaves Denmark, Sweden and the UK out of the Euro Area for the time being. It is premature because monetary unification instead of following political unification was actually used to push it forward, by creating the need for political unity. This is a risky course. It is like buying a suit that is too small in the hope that this will encourage one to get thinner. It does not work for me and I do not think it is working for the European Union. To put oneself voluntarily in a position of 'being forced to do something' betrays the lack of a serious will. As a consequence of the premature nature of monetary we have suffered the weak Euro. It's not just that the independent governor of the European Central Bank speaks too much and out of turn, says the wrong things and believes in high interest rate regardless of international markets sentiment, of exhortations by Bretton Woods institutions, and of consideration of EU economic performance. I bet you that today the interest rate in the Euro area will remain at the same level of 5 percent [*note: it did*]. The problem is that while only Mr. Alan Greenspan speaks for the dollar, too many discordant voices speak for the Euro, not only leaders and officials from the twelve countries that are EMU members but even any of the other three. For instance, every time Tony Blair or Gordon Brown say something mildly adverse to Britain quickly joining EMU, the

Euro weakens. Unlike the dollar, the Euro is not backed by Federal Government, Federal Budget and Federal Debt. When the idea of a European Monetary Union was first mooted there was talk of the single currency “crowning” European integration, instead of forcing it with a *fuite en avant*, a way to *sauter pour ne pas reculer*.

Accession candidates are still very far from any kind of convergence, whether institutional, fiscal and monetary or real. Institutional convergence is still not complete, nor can it be because the transition from the old system is not complete in the candidate countries. The Transition Scoreboard published since 1994 by the EBRD, in its annual Transition Report, assigns to each of the Bank’s countries of operation (now 27) a mark for its progress in different areas of economic transition: private sector share in GDP, large and small scale privatization, enterprise restructuring, price liberalization, trade and foreign exchange system, competition, banking, financial markets, legal reform. The score (apart from the private sector share) goes from 1 for little or no change to 4, with an additional star for OECD standards. Some countries are close to this ultimate score in some sector, but all are behind on average and in specific sectors (especially for restructuring, banking and financial markets). Yet countries score 1 just for doing nothing, thus looking as if they are almost 25 per cent on target before they even start. There is clearly an overoptimistic bias, which does not affect so much front-runners like Poland but which is very important not only for the countries that are lagging far behind but also for some of the accession candidates like Bulgaria and Romania.

Moreover the EBRD and other institutions take “progress” at its face value. They express subjective views that are often questionable. They neglect the need for system changes to reach a minimum critical mass. They do not take into account that if you are 50 percent on target you probably achieve less than 50 percent of what you would achieve if you attained your goal completely, hundred percent.

In the negotiations with the European Union there are 31 “chapters” that represent various aspects of this so called *acquis communautaire*, that is all the obligations that a member country must take upon itself. They concern the four freedoms of circulation of goods, people, services, capital; company law; competition policy; policy towards various sectors, regional policy, the environment, and so on. The chapters are “opened” when discussions and negotiations begin, they are never closed because all chapters will have to be closed at the same time, and they can be reopened before accession. You can judge how close various countries are converging by looking at how many and which chapters are opened and closed. The 30th chapter is "institutions" and has not yet been opened for any of the ten candidates, indicating that institutional convergence in these countries is lagging behind everything else; it will be open in the spring of 2002. For the record, by the end of March 2001 Poland and the Czech Republic had closed 13 of these chapters, Hungary and Slovenia – 14, Cyprus and Estonia, respectively, 17 and 16; and Bulgaria and Romania – 6. This is an indication that there is a lot of the way still to be covered. For its part the European Union in June 1993 had indicated that a condition of enlargement would be also its own ability to absorb the new members. And it is only in December 2000 that the EU declared at the Nice summit that it is now ready to take them.

There is, it would seem, an apparent monetary and fiscal convergence of accession candidates – if this is judged by compliance with the Maastricht criteria. At least the eight front candidates – all the East-European candidates minus Bulgaria and Romania – are actually very close to achieve these parameters. General government balance as a percentage of GDP in 2000 was a little above norm but within striking distance in the Czech Republic (4.2%) Romania (4%), Hungary (3.6), Lithuania and Slovakia (3.3) and otherwise observed by other accession candidates; this is a parameter relatively easy to achieve, once there is sufficient political determination. Debt as a percentage of GDP is below the critical limit of 60% of GDP everywhere except Bulgaria (at 95%, but still lower than Belgium Italy and Ireland at the time of their joining EMU). Inflation rates are further away from the Maastricht target, but above one digit only in Bulgaria and Romania; interest rates are furthest out of line, with Poland at 19.5% second only to Romania, but this is a matter of monetary policy rather than of fundamentals. As membership approaches, inflation and interest rates are beginning to converge to the EU average. Exchange rate variability is no greater than in the so-called Club Med (which includes Italy, Greece, Spain and – in spite of its Atlantic border, Portugal) five years before their accession.

The trouble is that in all candidate countries there are large scale external imbalances, near or above 5% of GDP, which are not part of the Maastricht conditions but are nevertheless a reflection of underlying macroeconomic imbalance and potential instability; here Poland is one of the worst offenders. Moreover, there are a number of skeletons in the cupboard of many of these countries. There are quasi-fiscal operations, consisting of extra-budgetary and/or deferred (including contingent) items, such as bad loans in the balance sheets of state banks, or the pension debt. These items more than double the public debt of the Czech Republic. Such operations clash with transparency and accountability, and are at the root of past and potential financial crises and currency crises. Poland is not as bad as the Czech Republic in this respect but recently has seen an increase of the share of non-performing loans in bank balance sheets. Beside the pension debt, there are other extra-budgetary funds. The satisfaction of fiscal criteria by accession candidates must be seriously reconsidered including these operations.

"Real" convergence is even more distant. Some people would argue that there is no operational, useful definition of real convergence but, on the contrary, there are many important indicators such as GDP per head, real wage, real exchange rate, unemployment, many other structural indicators. Here accession candidate countries exhibit very wide gaps with respect to existing EU members. Just looking at their total income, they will contribute to the EU less than 5 percent of its current income at official exchange rates. Their GDP is higher if it is evaluated at the exchange rates implicit in Purchasing Power Parity; for instance Poland then has 39.9 percent of the European Union average GDP per head, Hungary 51 percent, the Czech Republic 59 percent with Romania and Bulgaria, respectively at 29 and 23 percent. But these are still significant gaps.

This lack of real convergence involves the danger of large scale migrations, once borders are opened. It involves a large cost on the part of the European Union budget for transfers to the new members under the heading of structural and cohesion funds. It involves considerable cost for the larger share of agriculture that characterise the new members in both employment and income. These are all issues that appear significant in the 31 chapters of negotiations.

If I am allowed a brief digression I would like to consider an issue which now is of great interest in Poland, that of free circulation of persons, and the German proposal for suspending such circulation for seven years for the new members[3]. Germany has absorbed something like 65 percent of emigration from the East. The

[3] These considerations on migrations are based on a Report by the Economic Affairs Department of the Italian Council of Ministers and the Research Department of the Confederation of Italian Industry, "L'allargamento a Est dell'Unione Europea: sfide e opportunita' per l'Italia", edited by Ludovica Rizzotti, Rome, April 2001.

speech at which Gerhard Schroeder made this commitment was in the town of Rubenau, that is 30 kilometers from the Czech border, and therefore its citizens are genuinely concerned about migration; moreover there are elections in Germany next year. This problem, however, is very much exaggerated. There are two official studies, which project into the future massive migratory movements across German borders. One is based on what happened in the 1990s; the other is based on projections for the next decade and gives Poland as the main source of immigrants. There was great exaggeration in expected migrations in earlier enlargements, for instance when Greece joined the Union, but the inflows never actually materialized. In the case of Poland in the last years there has actually been negative migration of permanent migrants. The analysis of the 1990s includes migrations from Turkey, which is another prospective member of the Union. There are two problems for Germany. First, immigration from Yugoslavia and other Western-Balkan countries. Second, not so much permanent immigrants but temporary, daily immigrants who cross the border on really large scale. But these people benefit from the social welfare provisions in their home country; therefore the problem is much exaggerated.

Unfortunately, just as there cannot be EU enlargement without Poland, there cannot be enlargement without Germany; some compromise will have to be reached through mutual concessions. This is a consequence of the lack of real convergence. If unemployment in Poland had not shot back up to 16 percent from the achieved rate of 10 per cent, the migration issue would have been much less prominent in the negotiations.

Finally, one of the differences with previous accessions is the much higher degree of integration between existing members, involving higher hurdles for newcomers. Another difference is the fact that there is not only monetary unification but also many reforms going on in the European Union: reform of the Common Agriculture Policy, of decision rules, of the number and allocation of commissioners, voting and so on.

What are the implications? The lack of institutional convergence obviously is a serious problem: the further away we are from convergence the closer we are to the situation that prevailed in the old system. Even without well functioning, competitive markets, indeed even without domestic markets at all as in the Comecon days, trade can still occur. There was a great deal of trade between centrally planned economies and both the First and Third Worlds, and within Comecon, but integration opportunities were reduced and distorted – just as they are bound to be if European integration proceeds now without institutional convergence.

The lack of real convergence is equally serious. There is a paradox here: the less homogenous countries are, the greater is the potential for division of labor and therefore the greater potential advantages for gains from trade. Except that there may be some value added which is destroyed in these conditions, because trade may destroy not only activities which have a negative value added at international prices but also activities which are loss making but still make a positive contribution to net value added at international prices. Net advantages overall are likely to be positive but, as I said at the beginning, actual rather than potential over-compensation of losers by gainers is necessary.

In this respect the generosity of the European Union is not enough. European Commissioner Schreier provides an estimate of what the enlargement to the East would cost in terms of European Union GDP using the following approach. First, it is presumed that the European Union does not have to support farmers in the new member countries. It is argued that the EU is converting product subsidies into subsidies to its farmers' incomes, thus there does not seem to be any need to extend to East European farmers compensation for the loss of product subsidies which they never enjoyed. Second, it is assumed that in the period preceding accession in, say, 2004 (with negotiations concluded by 2002, plus two years for the ratification process) there will be sustained growth in the area, leading to grater real convergence and therefore lower need for intra-EU transfers. Third, there is already a provision that, under structural and cohesion funds, no country can receive more than 4 percent of its GDP. Now, if by 2004 the eastern candidates account for roughly 5 percent of the European Union GDP and cannot expect more than 4 percent of their GDP in aid from structural and cohesion funds, then the cost of additional aid will be no more than 4 percent of 5 percent, i.e. no more than 0.2 percent or 2 per thousand of European Union GDP. Such is the implacable arithmetic of the Schreier Theorem. I do not feel I am being populist by saying that this is simply not enough. Even a recent report by the Italian Council of Ministers and the Confederation of Italian Industry[4]

[4] See footnote 3 for details.

stated that it not plausible to exclude Polish farmers from Union support and to cap aid under structural funds at 0.002 of the European Union GDP.

In conclusion, closer economic integration is bound to be beneficial all round, even if somewhat premature. There are also immense political and societal gains, including the implementation of a dream of European unity and peace, but there will have to be a greater commitment both on the part of the European Union in terms of generosity and on the part of candidate countries in terms of the efforts needed to speed up convergence with the European Union.

To some extent both candidates and indeed non-candidate countries could speed up economic integration regardless of eventual accession. This can be done with greater trade access, whether mutually negotiated or unilaterally conceded by a non-member. Most of the effects of EMU membership could be replicated by unilateral Euroization, that is adopting the Euro as either an irrevocably fixed anchor (through a Currency Board as in Bulgaria and Estonia), or as a total replacement of the domestic currency. For instance, Euroization would bring about benefits from lower transaction costs and lower interest rates, at the cost of a loss of seigniorage and potential exposure to asymmetric shocks. Net benefits from such possible acceleration are a matter for empirical research and should not be taken for granted [5].

European enlargement is not quite "irreversible", as some politicians are fond of saying, simply because it has not happened yet, but it is unstoppable. Poland *is* European enlargement to the East. The process is fraught with the difficulties and tensions of required convergence. Enlargement will bring widespread advantages but also costs for all of us – I can see them whether I wear my Anglo-Italian hat or my Polish honorary citizen's hat - but it will still be well worth it. Thank you.

Academy of Economics in Poznań: As I understand your lecture, there are a lot of problems and there is a long way to go still. But if you were to determine those countries that should join the European Union in the first wave, strictly from

[5] See D.M. Nuti (2000), Costs and benefits of Euroisation in central eastern Europe, before or instead of EMU membership, CNEM Working Paper n. 10, London Business School. For a more optimistic stance see Robert Mundell (2000), *The International Financial Architecture. The Euro Zone and its Enlargement in Eastern Europe*, Distinguished Lectures Series n. 1, WSPiZ, Warsaw.

economic point of view, what would it be and what do you think will be the political outcome of the accession?

D. Mario Nuti: From an economic point of view the front-runners, including Poland, are in a good position to reap early benefits from an early accession. Of course there are many structural problems to be resolved. Agriculture is a major concern. Here the paradox is that Poland is much closer to international prices for agricultural goods than the European Union is. The European Union is bound to require higher tariff levels towards the rest of the world than Poland has at the moment. There will be a lot of room for negotiations there to reduce the cost of adjustment in agriculture. As I said, there is a bit of spring-cleaning and housecleaning to be done in the banking system, there is restructuring of sectors which unfortunately are the same sectors which are being restructured or have been just restructured in the European Union (like steel, textiles, chemicals, etc.). Once these hurdles are resolved, I think Poland and the other early candidates are in a good position to benefit from expansion of trade and of foreign direct investment. At the moment the European Union is running a large-scale surplus deficit which turned into a rapidly growing surplus, first with some of the candidates, then with the entire area, now of the order of 20 billions Euros. In 1989 it was running a 1 billion ECU practically with the whole area, including the so called sensitive sectors which were the main preoccupation in Brussels. The mutual opening of trade further than it has already been achieved is bound to reduce this surplus, and therefore the eastern members' deficits including that of Poland. Of course, a high current account deficit in Poland is a major preoccupation.

Politically, I think you are in a better position than I am to assess the implications of membership. In Italy we regard membership as a constraint on populism on the part of government, a constraint on the possible danger of democratic reversals. The political elections of 13 May pose the threat of a winning coalition that includes fascist and secessionist groups, while its leader has an unprecedented conflict of interests with the state, but our EU membership is reassuring because it sets common standards and limits the scope of these adverse phenomena. At least in this respect Poland will also gain political advantages from membership.

If by political outcome you mean how will support for Europe change on the run up to membership or immediately afterwards, I think there is at the moment a considerable enlargement fatigue. Support for enlargement is slipping both in Poland and in the rest of Europe, but this is more an implication of the difficulties and obstacles that I have listed and therefore the accompanying frustration, rather than a genuine opposition to the project.

Krzysztof Kobeszko, Białystok University: When will Poland become an equal member of the European Union community? By an equal member we mean the member with the full rights as the other members.

D. Mario Nuti: The best estimate for a full membership is 2004. It is widely believed that in 2002 the negotiations with the frontrunners – among which I include Poland - will be finished and therefore – taking into account the time required by all the countries involved to ratify accession - we can look at 2004 as the earliest effective date. Presumably, there will be some transitional period. Spain had a 7 year transition period in which it was allowed to retain high tariffs and gradually reduce them and then several additional years in which was allowed exemptions from some of the rules of the single market. You can envisage some kind of transition period in the next round of accessions.

The European Commission, however, is very reluctant to allow any derogation. In fact, there have been complaints that new members are going to face stricter conditions than existing members do. For instance, the UK has derogation on membership in the European Monetary Union whereas new candidates are not allowed this kind of derogation. There are various requests for derogation which are being examined at the moment by the European Commission, but presumably derogations will be few and will all be temporary. There is a transition period in the participation in European elections but the numbers of seats in the European Parliament have already been fixed, it seems to everybody's satisfaction, on the basis mostly of country population. Already by joining, Poland would be entitled to have one Commissioner in the European Commission, so you would be part of what is de facto the European government. Once the number of members will exceed 25, there will have to be a rotation among Commissioners, simply because there are not enough posts. But the chances are that – once Poland is admitted – it will be an equal member subject to the various transitional arrangements, which are not unprecedented.

The big question is when would Poland join the Euro. When I was working with Professor Kołodko in his capacity as premier, we produced a pamphlet entitled *Euro 2000* in which 2006 was regarded as the most likely date. If we presume that negotiations will be ended by 2002 and accession will take place in 2004, plus two years membership in the European Exchange Rate Mechanism II required for joining EMU, our estimate of 2006 as the date of Poland joining the Euro was pretty good. By that date Poland would be close to full membership, full equal rights as you put it.

High School of Business in Nowy Sącz: As we know from your lecture and from political and economical situation in Europe, Poland for 10 years has been in the first league of Eastern and Central European countries which want to access The European Union. Now we have got some signals from western countries that many politicians and economists place us in the second league with countries like Romania, Bulgaria. Probably the most important reason is unemployment in Poland. What do you think what our government should do to decrease our unemployment? In your opinion, are we still in the first with countries like Czech Republic, Estonia and Hungary or in the second league?

D. Mario Nuti: This the first time that I hear the rumor that Poland might be downgraded to the bottom group. Its position in the accession queue first improved from second or third place to first, around 1997 when the Czech Republic and Hungary had their problems, then has perhaps deteriorated but without ever leaving the first group. To place Poland with Romania and Bulgaria would be grotesque.

Obviously, large-scale unemployment is a great concern. The OECD has recently published a forecast that unemployment is going to reach 17 percent. It is true that – we were discussing it earlier with Professor Kołodko – this is pure and simple extrapolation, without much reasoning behind it. Unemployment can fall as well as rise. But the rise of unemployment back to the levels of 1993 and above is of course a signal of lack of real convergence with the rest of Europe.

What can we do to lower unemployment? For a start, we need a lower interest rate: a 20% interest rate for a currency that has been appreciating in nominal terms with respect to both the Euro and the US dollar is insane; it deters investment and through its impact on the exchange rate and exports produces and perpetuates unemployment. The trouble is the fashion – not supported by any solid economic theory – of central bank independence. Independent central bankers need to co-ordinate their policies with equally independent finance ministers and if they do not do it this coordination failure has a cost in terms of unemployment. This is happening in the Euro area and has happened consistently in Poland. By the way, in Poland seigniorage has been calculated as being next to zero instead of the 2 or 3 percent that could be expected in a similar country. Why? Because of the cost of central bank policies: high interest rates, leading to both unemployment and high capital inflows, involve a high cost of sterilisation, that is of borrowing back from the public the money which is being injected into the system, at an interest rate higher than the rate which the bank actually earns on its reserves. Much of the responsibility of unemployment, in Europe as in Poland, must be placed at the door of the central bank.

But there can be other remedies: for instance, within fiscal policy there can be an expenditure switch from current consumption to public investment. To the extent that this is possible, it will promote employment. There can be some kind of pact with the unions so as to contain the growth of wages and promote employment through that route. But of course some assurance and some counterpart must be given in exchange for wage moderation.

What is needed is a development policy precisely of the kind that was pursued in Poland in 1994-1997, when unemployment fell from 16 to 10 percent and growth resumed at accelerated rates of 6-7 percent. Ultimately this growth is what is going to reduce unemployment.

A competitive exchange rate is also part of the solution. Of course, *cudów nie ma* (‘there are no miracles’)

Maciej Piekierkiewicz, Warsaw School of Economics: What is your opinion about agricultural reconstruction of Poland in the context of integration with the European Union?

D. Mario Nuti: This is a very difficult question, a very thorny issue. First, I believe it is now generally accepted that agricultural employment statistics in Poland are very much overestimated. But what is very worrying is that agriculture in Poland is exceedingly fragmented. I believe that in Poland around 1990 there were almost as many production units below 2 hectares as in the entire European Union of twelve. The privatisation of agriculture has actually led to an increase in the number of farms. It is a question of consolidating units that are non-viable due to their small size and of re-establishing an older farming tradition different from subsistence farming.

We should remember that Poland is actually a net importer of food, so after restructuring there should be some prospects for development in agriculture. Except that Poland is subject to the competition of subsidised agricultural exports from the European Union. There is a lot of room for negotiations there, involving reciprocal trade access to various market segments.

Yesterday's newspapers spoke of a forthcoming meeting in Brussels with Polish farmers which is expected to lead nowhere because the Union will not say whether or not it will extend support to Polish farmers and if so to what extent. There is no way that negotiations can get anywhere until this issue is settled. Clearly the Union would like to see the Polish budget to take on at least some, and possibly all of the cost of support to farmers' livelihood, but Poland cannot be expected to resolve agricultural restructuring at a stroke without external assistance. It will take time, it needs support and there will have to be negotiations possibly involving counterparts, such as Polish concessions on foreign ownership of land or on emigration. There will have to be some "give and take" on all parts; until then there will be a lot of "wait and see" – a strategy very common both in Brussels and in Frankfurt.

Klaudia Żaczek, Warsaw University: We are wondering what is your opinion on the report which was published last week in Die Welt which states that unless international capital flows to Poland, financial crisis may appear.

D. Mario Nuti: There is a certain consensus in international financial circles that the danger level for a country's current account deficit is around 5 percent of GDP. Here standards have tightened recently, due to frequent international crises. Three or four years ago the danger level was believed to be around 8 percent, but last year Larry Summers, then Secretary of the US Treasury, at the AEA annual meeting in Boston argued most forcefully that 5 percent was the limit. I suppose the United States does not have to live up to that exhortation, but then they have worldwide seigniorage and they can afford it. Last year Poland had a current account deficit of 6.5 percent of GDP which is, if not above, fairly close to the danger limit wherever we place it. However, I understand that most of this deficit, to the tune of 5 percent of GDP, is financed by foreign direct investment which is not as volatile as short-term financial investment. Of course even FDI can be reversed: you can dispose of a factory locally and export the proceeds abroad, but real assets are more illiquid than financial assets, as they involve higher transaction costs. Therefore the notion that foreign direct investment is going to be moved out of the country precipitating a crisis is not plausible.

Of course, there is still a lot of financial capital coming in and it has been used to fund this current account deficit but its size and the instruments that are still at the disposal of the central bank, if these instruments are used correctly. Thus Poland raises concerns about the sustainability of its current account imbalance in the longer term but is still far from a possible financial crisis. If we look at recent crises in the area, the Russian crisis of August 1998 was a crises of a massive short term government debt denominated in dollars, at interest rates which represented an inordinate burden on the budget and which were not sustainable in the long run. The Czech crisis of 1997 had an element of contagion from Southeast Asia and was due to excessive external indebtedness by commercial banks with lots of bad loans in their balance sheets. Poland does not resemble to either of these cases.

The trouble with financial flows is their reversibility and volatility. Thus the major structural problem for Poland is to bring down its current account deficit to more manageable and more sustainable levels. But there is no immediate risk of a currency crisis comparable to those that occurred in other countries in the area.

Damian Bielawski, Science Club "Little Tigers", Leon Koźmiński Academy of Entrepreneurship and Management: Could you tell us something more about advice for our central bank? You said that we need lower interest rate to reduce unemployment, could you comment this and say something more?

D. Mario Nuti: Obviously, the interest rate must be decided simultaneously with exchange rate policy and not on its own. What the central bank tends to forget is that a higher interest rate does not necessarily strengthen the exchange rate, because this is affected not only by interest rate differential relatively to the inflation differential with other countries, but is affected also by a country's growth prospects. This is why Alan Greenspan can lower the interest rate and strengthen the dollar at the same time, whereas Wim Duisenberg often by not reducing interest rates has been damaging the Euro rather than helping it. I would not want to stick my neck out and say that this is exactly what is happening in Poland now. However, I can say for sure, by looking at past experience with the previous management of the National Bank of Poland, that there have been many times when high interest rates have driven the exchange rate too high with respect to the requirements of export competitiveness, and have involved a significant loss for sterilisation costs undertaken by the bank that were not necessary. Financial capital was flowing in because of the interest rate differential, and then it had to be sterilised in order to avoid excess monetary expansion, and sterilisation it was costly precisely because of that differential.

Indeed, I once wrote a paper entitled "The Case for Privatising the Central Bank of Poland"[6] because there is no reason why a public institution should dilapidate something of the order of 2 percent of GDP or more by undertaking these policies. Independent Central Bankers are fine as long as they are subject to political accountability, as long as they are independent in the choice of policies but not in the choice of targets. There are the first signs of a general rethinking about this kind of schizophrenia in which we indulge the government on the one hand and the central bank on the other, about short-sighted policies and the myth about high interest rates which have become a virility symbol. Once governments are committed to respect various fiscal parameters, as they are committed in the European Union and in the candidate countries, the case (if any) for independent central banks is considerably reduced.

Marcin Piątkowski, TIGER, Leon Koźmiński Academy of Entrepreneurship and Management: Dear Professor, when students go out on a Saturday night they not only care about joining a party but they also care about what kind of people they would be joining, or in other words, who would they be having fun with. Per analogy, I do believe that Poland should be much more thinking about what kind of club we are joining instead of being preoccupied with the final date of integration only as if the timing an accession would be a cure to all ills. In the long run it is not going to matter if we are joining in 2004 or 2005 or perhaps even 2006, although I do agree that the sooner, the better. I am then curious about your comments on this issue.

D. Mario Nuti: Vaclav Klaus used to say that he was not be at all keen for the Czech Republic to join the European Union, for it is an organisation characterised by state interventionism. I believe he was bluffing. Even before becoming members, you already have indirectly a say in the way the European Union develops. When agricultural policy towards new members is discussed, this brings automatically into discussion the continuation of CAP. When you are discussing access to structural funds, you are already involved in having a say in the way that the European Union is developing in that direction: whether the threshold below which you have access to structural funds support we is going to be 75 percent or 82 per cent of the average income of the Union, many of the European Union regions which currently get the support would be left out (75 percent would deprive Italy completely of access to structural funds). De facto you already have a say on the way current members organise the club you wish to join.

For many people there is a hope that the enlargement itself might have some beneficial influence on the Union by bringing about greater concern for social issues, which figure so prominently on the agenda of the candidate countries that they might dilute the negative influence of larger countries. It is for you to say in what way you would like to change the club's rules. Whatever change you want you are bound to find some allies within the Union according to how you formulate your request.

Finally, joining an economic union is a bit like going on a school outing: you may not like its timing, the company, the destination, but you may well be better off than staying at home…

Rebekah Sundin, visiting student at the Warsaw School of Economics and the Leon Koźmiński Academy of Entrepreneurship and Management: Given the spending capacity of the structural funds of the EU, the four percent ceiling of the GDP recipient countries, as well as the stringent cost, that is, the massive costs of the

[6] Paper presented at the 4-th Dubrovnik Conference on the Economics of Transition, June 1998.

convergence of the new member prospective countries--it seems to be a very expensive accession. My question to you is: do you believe that the EU contributions are fair, are they economically conceivable without crippling the economies of the new prospective countries? This is again in light of the prospective benefits that EU enlargement will bring, and again in perspective of the stringent conditions that the EU is imposing.

D. Mario Nuti: Are you referring to the lack of generosity of the European Union vis a vis the candidate countries or are you thinking of whether or not the European Union should increase its grip on the Union income for its own purposes?

Rebekah Sundin: Not so much generosity, but is the amount they are offering prospective countries actually fair? Is the amount fair as compared to the benefits the EU will also gain due to enlargement? Or is the EU asking too much – is the cost for the EU countries going to be more that they can handle? Will the EU be able to make more concessions if necessary? Is the amount they are willing to provide under Agenda 2000 going to be adequate?

D. Mario Nuti: This is a difficult question, because the line taken by the European Union has been that enlargement was not going to be associated with an increase in EU command over the area's resources. In the policy of the Union each country contributes according to its GDP, therefore there is no room for a diversified treatment on the contribution side. Redistribution within the Union takes place exclusively through its expenditure policy. And the Union has decided not to increase its command over total resources but to redistribute between old and new members. This is a decision which was taken basically in Berlin in 1999 with the so called Agenda 2000, which is probably out of date in some respects but it is still on course as far as one can see. There is hardly any room for manoeuvre within that tight budget, which is taken primarily by CAP, although its share has fallen from a peak of 80% to the current proportion of 64 to 65 per cent. Adding the various structural funds, cohesion funds, and so on – there is very little room for manoeuvre. Many people feel that there should be either the relaxation of the rule that the European Union budget should not be funded by borrowing, or perhaps greater command over the EU resources on a scale greater than the current purely symbolic rate of 1.5 percent. Otherwise it is impossible to provide assistance on the scale required by a smooth enlargement process. Here the lack of political unification, i.e. the lack of central or federal state institutions, is a major obstacle to raising EU command over EU area resources.