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# EU Enlargement: Economic Implications for the United States

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## Summary

The United States strongly supported the formation of the European Economic Community in the 1950s and has supported its subsequent expansions and evolution into what is now the European Union (EU). Likewise, the United States, under both the Clinton and Bush Administrations, welcomed the latest, and largest expansion of the EU — the addition of 10 new members effective May 1, 2004, viewing it as helping to promote stability and prosperity throughout the continent. The enlargement of the EU will change U.S. economic ties with the EU with the 10 new members. This report examines the changes and their potential economic impact on the United States. Many Members of Congress have been monitoring the potential effects of enlargement on the U.S. economy, particularly agriculture, and they will likely continue to do so during the second session of the 109th Congress. This report will be updated as events warrant.

## Scope of EU Enlargement

On May 1, 2004, after several years of negotiations, the European Union (EU) completed the largest expansion of its membership since its inception as the European Coal and Steel Community in 1952. It added 10 countries bringing its total membership to 25.[1] The enlargement increases the total EU population from about 380 million to roughly 450 million people.

Perhaps more significant than the size of the new membership is its composition. Eight of the 10 new members are former communist states and three of the eight (Estonia, Latvia, and Lithuania) were part of the former Soviet Union. The eight former communist states have been successfully making the transition from centrally-planned economic

[1] The 10 new members are Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia. They join Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom. For more background on the negotiations and political implications of the enlargement, see CRS Report RS21344, *European Union Enlargement*, by (name redacted).

systems to market-driven economic systems, although some legacies of the old system remain.

The 10 new EU members are on average poorer than the previous EU-15. Poland, the largest of the10 new members, is substantially behind Portugal — the "poorest"of the EU-15 in terms of per capita GDP measured on a purchasing power parity (PPP) basis. Slovenia, the "richest"of the former communist states, is also among the smallest of the 10, and is slightly above Portugal in terms of per capita GDP.[2] Thus, the addition of the10 countries moves the EU further from its original configuration — a group of relatively rich, industrialized West European economies. That trend creates challenges for the new members and the other 15 members as they absorb the inevitable adjustment costs of enlargement. At the same time, accession to the EU affirms the commitment of the former communist states to building market economies.

In joining the EU, the 10 new members accede to a range of laws and regulations that affect virtually every aspect of economic life. At the same time, EU membership accords its members a number of benefits. In joining the EU, the 10 new members become integrated into a large borderless market. Tariffs are eliminated on trade with the other EU members. (Tariffs on EU trade with the new members were eliminated prior to accession via pre-accession association agreements.) In addition, EU members adhere to common legal and regulatory regimes — the same safety, health, professional qualification, and other standards apply in all 25 countries. This means that goods and services can flow freely throughout the EU area. The 10 new members also have committed to join the Economic and Monetary Union (EMU) that requires close coordination of economic and monetary policies. They have pegged their national currencies to the euro and are to eventually adopt the euro as their national currency after they have met the economic eligibility criteria. An important aspect of the EMU is the free flow of capital among members, the objective of which is to create a stable economic environment and efficient distribution of capital. Eventually, labor from the 10 new members is to be able to move freely throughout the EU area, enabling a worker in one member country to obtain work in another member country without restrictions other than those that would apply to a local worker.

An important aspect of EU membership is the sometimes controversial Common Agricultural Policy (CAP). The CAP is a set of laws and practices that are designed to increase the supply of agricultural products at reasonable prices but also provide income support to farmers. The CAP operates according to three basic principles: the free movement of agricultural products within the EU at common prices, no national trade barriers, and harmonized technical regulations; (2) preference for EU products enforced through protectionist measures; and (3) financing of the CAP from the EU budget. In order to maintain common prices and producer income support, the EU employs commodity intervention — buying products to boost demand, and direct payments to farmers.[3] These programs account for a large share of the EU budget, forcing the EU to consider CAP reforms. In addition, the EU's trading partners, including the United

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[2] The analysis is based on data contained in The World Bank. *World Development Indicators — 2004.* Washington. p. 14-16.

[3] CRS Report RL30753, *Agricultural Support Mechanisms in the European Union: A Comparison with the United States*, by Geoffrey Becker.

States, have strongly criticized the CAP, arguing that it distorts production patterns creating agricultural surpluses that the EU dumps on the world market at the expense of U.S. producers.

Along with the unified internal market, the 10 new members accede to a common commercial policy. This policy includes a common external tariff regime. (Member countries impose the same tariffs on imports from non-member countries.) The EU-10 members belong to the WTO and have been participating in the negotiated reduction in tariffs.

EU members conduct trade policy as one. They negotiate bilaterally with non-member trading partners and within the WTO; apply trade remedies, such as antidumping duties and countervailing duties, in tandem and are themselves subject to similar trade remedy measures imposed by non-member trading partners (what is imposed on one is imposed on them all); and employ common trade preference programs, such as the EU Generalized System of Preferences (GSP) program for developing countries.

While incurring these obligations requires the new members to surrender some national control over their economic policies, they stand to reap a number of benefits. For example, they receive EU structural funds to help develop transportation and other infrastructure facilities and to modernize their agricultural sectors to bring them up to the levels of development of other EU members. The new members will also receive agricultural support funds as part of the Common Agricultural Policy (CAP). However, they are to receive less than the full complement of CAP funds for the first ten years of their membership but are to receive the full complement thereafter.

EU membership is expected to encourage economic growth and development of the new member economies. The European Commission estimates that EU membership will add one percent per year to the GDP growth rates of the new members during the first ten years of their membership.[4] The economic boost would result from a more efficient distribution of resources with the removal of barriers to trade with the other 15 members and from the economies of scale that producers in the new member countries would realize by joining the large EU market.

## U.S. Economic Ties with the EU

The United States has strong economic ties with the EU-15 countries that have developed over many years. Its ties with the 10 new members are not as firm, having largely developed since the end of the Cold War.

**U.S. Ties with the EU-15.** The United States has been a strong advocate for the construction of close economic ties among the West European countries since the end of World War II. During the Cold War, the European Community served U.S. foreign policy and national security interests as a force of stability that drew (West) Germany and France closer together and that helped to build Western Europe into an economic bulwark against the Soviet Bloc.

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[4] European Commission. *More Unity and More Diversity: The European Union's Biggest Enlargement.* p.7. [http://europa.eu.int].

The formation of an economically unified Europe has served U.S. economic interests as well by accelerating European economic growth and development which has opened trade and investment opportunities for the United States. Many studies have concluded that the formation of the EU has had a net positive economic impact on the world as a whole because it has led on balance to more trade *creation* than *diversion* of trade from other countries.[5]

The United States and the EU-15 have built a strong economic relationship grounded in large flows of trade and investment in both directions that promote economic growth and employment in both regions and rooted in the principles of open, market economies. In 2003, $808 billion flowed between the United States and the EU-15 on the current account, the most comprehensive measure of U.S. trade flows. In addition, U.S. residents invested a net $71.7 billion in EU-15 countries in direct investments, while EU residents invested $37.0 billion in direct investments in the United States.

A very large part of U.S.-EU economic ties operate smoothly with little friction or hurdles. Nevertheless, disagreements over government policies and practices have arisen between the two trading powers that have led, in some cases, to sanctions and created political problems at the highest political levels. Currently the most visible issue pertains to U.S. compliance with a World Trade Organization's (WTO) ruling against the U.S. foreign sale corporation program (FSC) and its successor program, the extraterritorial income (ETI) program that provides tax incentives for exporting.[6] The EU is also a party to a complaint brought to the WTO against the United States regarding the Continued Dumping and Subsidy Offset Act of 2000 (CDSOA) that required revenues from antidumping and countervailing duty orders to be redistributed to entities that were parties to the original antidumping and countervailing duty cases and that fulfilled statutory eligibility criteria. At the same time, negotiations with the EU over compensation to the United States for the EU ban on imports of hormone-treated beef continue.[7] The WTO ruled that the ban violates the WTO Sanitary and Phytosanitary agreement.

**U.S. Ties with the New Members.** U.S. trade with the 10 new members of the EU (EU-10) has grown substantially in the last decade, but nevertheless remains relatively small. In 2003, total U.S. exports to the EU-10 totaled $3.6 billion or about 0.5% of total U.S. exports to the world. U.S. imports from the group totaled $8.2 billion, about 0.7% of total U.S. imports. U.S. imports from the EU-10 surged $1.7 billion, or about 26%, in 2003. About 46% of the increase was accounted for by the increase in imports from Slovakia, from $261 million (2002) to $1,013 million, nearly all of which were passenger cars. Slovakia is the home of a new Volkswagen production facility.

Hungary is the largest U.S. trading partner among the ten countries in terms of total trade, Poland is second, and the Czech Republic is a close third. Largely because of the association agreements that provide for mutual preferential trade treatment, the EU-10

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[5] Studies on the economic effects of the EU cited in CRS Report 97-663, *Regional Trade Agreements: Implications for U.S. Trade Policy*, by George Holliday, p. 8.

[6] For more information on the FSC/ETI issue see CRS Report RS21742, *European Trade Retaliation: The FSC/ETI Case*, by (name redacted).

[7] United States Trade Representative. *2004 National Trade Estimate Report: Foreign Trade Barriers*. Washington. April 2004. p. 143.

economies have become increasingly integrated with the rest of the EU, with at least half of their total trade taking place with the EU-15 prior to accession. EU members have also been the leading source of foreign investment in those economies followed by the United States. For Estonia, Latvia, Lithuania, the Czech Republic, Slovakia, Hungary, and Poland, this posture represents a significant re-orientation of their economies which had been closely tied to the Soviet Bloc before the collapse of the Soviet Union.

U.S. exports to the EU-10 are led by computers and parts, office machinery and electrical machinery, primarily integrated circuits. U.S. imports from the EU-10 are led by cars, computers and parts, and electrical machinery.

## Economic Implications of EU Enlargement for the United States

U.S. trade with the EU-10 has been small, dwarfed by the already strong EU-U.S. trade relationship; therefore, the impact of enlargement on the overall U.S.-EU relationship will be minimal. However, enlargement could change U.S. economic relations with the 10 new member countries.

For example, EU accession is expected to result in additional economic growth in the EU-10 which could translate into some increase in demand for U.S. exports. In addition, the EU-10 countries' adoption of the Common External Tariff changes the tariffs U.S. exporters face in those markets. On average, EU tariffs are lower than the original national tariffs of the new members. For example, tariffs on trucks and cars were much higher in central and east European countries than in the EU.[8] The lower tariffs should improve the U.S. export opportunities in the EU-10 markets.

In some cases, tariffs under the common external tariff are higher. One study points out, for example, that while tariffs in the largest EU-10 economies, notably Poland and Hungary, were higher than EU tariffs, tariffs in some of the smaller countries, for example, the Czech Republic and Estonia, were lower, reducing export opportunities in those markets. [9] The United States claims it is entitled to compensation in those cases. Article XXIV of the General Agreement on Tariffs and Trade (GATT 1994) states that if the formation of a free trade area or customs union results in higher tariffs on imports from countries outside the area, then the negatively affected countries are entitled to compensation in the form of reductions in tariffs in other areas. The EU has begun negotiations with the United States and other affected trading partners regarding compensation. The United States submitted a list of products that it believes will be adversely affected by enlargement. EU officials have argued, on the other hand, that the benefits that non-EU trading partners will receive from enlargement will more than outweigh the disadvantages, negating any need for compensation.[10] The United States and the EU are conducting talks to resolve the issues. The EU extended a WTO sanctioned

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[8] Crane, Keith. *European Union Enlargement: Economic and Financial Implications for the United States* in The American Institute for Contemporary German Studies. *EU Enlargement and Transatlantic Relations: Background and Analyses.* AICGS Policy Report no. 7. 2003. p. 69-70.

[9] Ibid., p. 68-69.

[10] *International Trade Reporter*. May 6, 2004. p. 775.

deadline for WTO members to resolve the issues through consultation until May 1, 2005.[11] On November 30, 2005, the EU and the United States announced an agreement on compensation to the United States. Among other things, the EU has agreed to reduce tariffs on imports of certain fish, protein concentrates, certain chemicals, and aluminum tube and raise quotas on imports of boneless ham, poultry, and corn gluten.[12]

The United States removed the nine of the 10 countries (all but Slovenia) that were eligible from its Generalized System of Preferences (GSP) program because U.S. law prohibits EU states from eligibility. Therefore, their products are no longer eligible for duty-free treatment from the United States. The United States negotiated with the new members to ensure that rights U.S. investors had previously secured under bilateral investment treaties (BITs) would be preserved afer enlargement.

Keith Crane, senior economist at RAND Corporation has identified other potential advantages to the United States coming from EU enlargement:[13] U.S. exporters will no longer have to re-certify their products for sale in the EU-10, that are already eligible in the EU-15; U.S. companies may be able to consolidate their operations in Europe since they will be servicing one, larger market. Crane also identifies some possible problem areas: EU subsidies under the CAP to agricultural producers in the new member countries could lead to overcapacity and surplus production exacerbating U.S. concerns about EU dumping of agricultural products in third country markets at the expense of U.S. exporters; the new members will adopt the EU ban on imports of U.S. hormone-fed beef, costing beef exporters those markets; and U.S. companies will no longer be able to benefit from investment incentives offered by the governments of some of the new members because the EU has prohibited such programs.

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[11] EU Gives U.S., WTO Members More Time for Enlargement Negotiations. *Inside U.S. Trade.* October 8, 2004.

[12] *Washington Trade Daily.* December 1, 1005. p. 5,6.

[13] Crane. p. 71-75.

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