Comment on P. Subacchi: «What does a larger EU mean for the European economy? Looking at 2005 and beyond»

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The paper provides...

- a short-term outlook for the EU economies on 2005;
- more fundamental considerations whether enlargement makes any difference to the EU as a whole;
- a view on the long-term prospects for closing the income gap between the EU-15 and the new member countries;
- useful comparisons with Southern enlargement, the catch-up process in Ireland, and the prospects for major developing countries.

The main conclusions are full of common sense and certainly plausible – although I am probably a bit more concerned about potential frictions during integration.

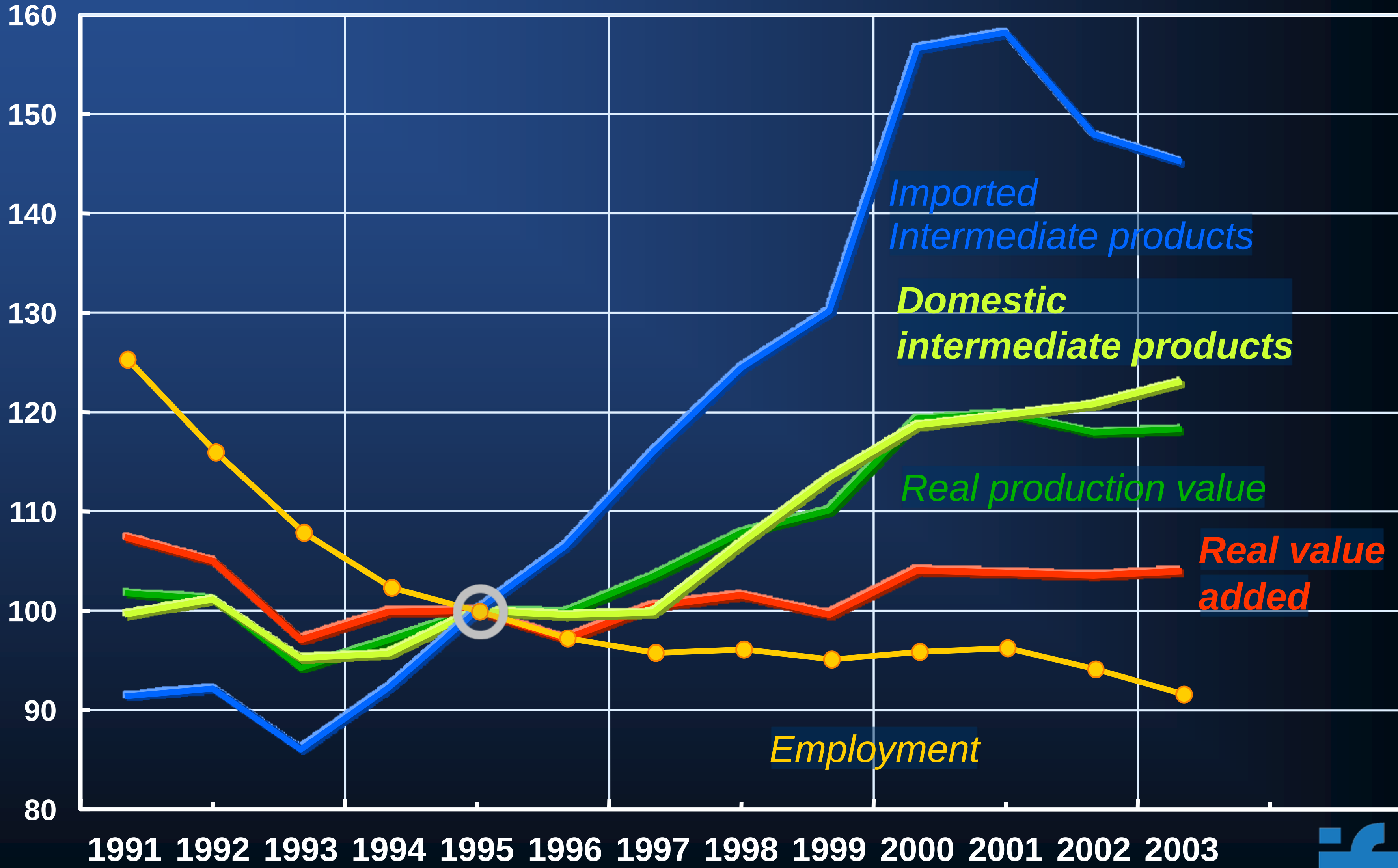
Potential frictions

- That increased trade and capital flows increase GDP – a lot more in Eastern Europe than in Western Europe – is a conventional result from aggregate CGE models.
- It may miss part of the microeconomics of integration, where Eastward FDI may have negative repercussions on growth in (some of) the former EU-15.
- Take Germany as an example (where enlargement means that globalization is at our door).

Expectations for 2004:

- Exports: + 10.2 per cent
- Investment: – 1.0 per cent
- Consumption: – 0.1 per cent
- Imports: + 6. 7 per cent

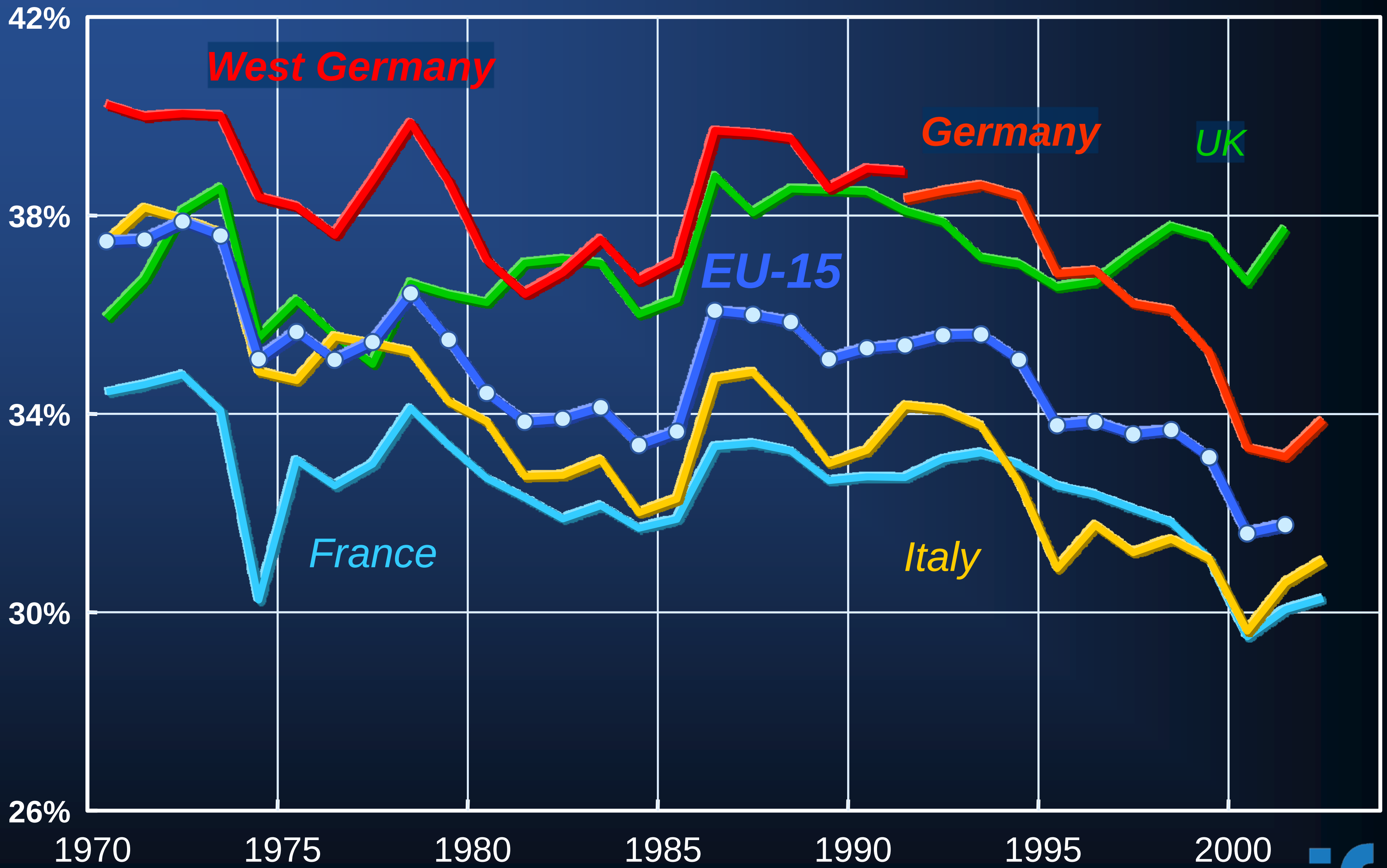
Components of growth in German industrial production (manufacturing) 1995 to 2003, 1995 = 100



Sources: Federal Statistical Office; Ifo calculations and estimates.

Ifo Institute for Economic Research at the University of Munich

Domestic value added in industrial production (manufacturing)



Sources: OECD; Ifo calculations.

Potential frictions (cont'd.)

- The German example is certainly special (and we are genuinely puzzled by what we observe there).
- Also, some business relocation and structural change is clearly part of the story about gains from trade.
- It is thus hard to say how much of this is “too much”; yet, the case of Germany may be taken to overshoot an optimum, however this might be defined.

- The expectation that it can take a long time until the income gap will be closed is therefore not very comforting.

Does size (alone) matter?

- Throughout, the paper stresses that size matters for long-term economic development – a caveat:
- This is mainly an assumption, not an analytical result.
- Size of what? (Population, aggregate output, output growth, output per capita?)
- Examples:
  - China (few will doubt that it is about to become a major player)
  - Russia, India, Brazil (assessment probably less unanimous)
  - Ireland, a counter-example?
- A “generalized gravitation model” may not capture everything that matters for sustained economic growth.