



The Cost of European Environmental Regulations in the Accession Countries of Central and Eastern Europe

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Contents

Executive Summary	4
1. The Recovery of Central and Eastern Europe	7
2. Case Study: The Slovak Republic	8
3. The General Region	9
4. Entry to the European Union	9
5. Problems of Entry	9
6. Environmental Regulation	10
7. Costs of Regulatory Compliance	13
8. Environmental Protection in the Post-Communist New Member States	14
9. A Hidden Agenda?	19
10. Concluding Remarks	20

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Executive Summary

- Prior to the democratic revolution of 1989 most of former communist Central and Eastern Europe was a semi-bankrupt rust belt. However, by the end of the century the fundamentals had been put in place for recovery. Privatisation was largely complete. There were flourishing domestic capital markets and clearly established legal frameworks to ensure property titles and to enforce contracts.
- Many countries in the region made spectacular progress – particularly during the late 1990s. With flexible and competitive labour markets and the introduction of low flat taxes growth rates across the region have been much higher than in Western Europe. By 2007 for example, it is predicted that Slovakia will be producing 850,000 cars a year, making it by far the largest car producer in the world *per capita*.
- While membership of the European Union has been an important symbolic goal for the countries of Central and Eastern Europe, it has also been hoped that membership would bring open and equal access to all European Union markets and would therefore automatically bring the new member states the advantage of established free trade agreements with the rest of the world. However, as an international body similar in nature to a federal state, the European Union has insisted on the imposition of a host of common standards, actual or proposed, of taxation and corporate organisation, of consumer protection, of health and safety, and of environmental protection.
- Taken together, these laws fill about 85,000 pages, and constitute every legal instrument made since the 1950s. They cover everything from the minimum rate of value added tax to the recycling of refrigerators. They are collectively known as the *Acquis Communautaire*. This whole library of often highly complex legislation has been built up over two generations. For the 15 western member states, there have been long periods of familiarisation with all of its contents and often long periods of derogation during which they could adapt to the new conditions. The ten new member states were required as a condition of joining to accept every single page on the day of joining.
- Since the 1970s, the European Union has taken an increasing interest in all areas of environmental regulation. Today, some 200 pieces of legislation have been adopted and are in force, concerned chiefly with minimum standards for waste management and water and air pollution. There are now laws on everything from the avoidance of climate change to the recycling of wine bottles. In 2005 the European Emissions Trading Scheme will introduce a highly bureaucratic set of regulations to achieve the Kyoto targets of cutting carbon emissions by 8 per cent.
- The basic principles of European Union environment protection law are: precaution, prevention, liability for damages, cooperation, and access to information. For the authors, the highly damaging precautionary principle means that in cases when serious harm is threatened, positive action to protect the environment should not be

delayed until irrefutable scientific proof of harm is available. As such, it assumes that certain economic activities will always produce external costs. And it unfortunately represents a new legal principle. In its strongest formulations this principle can be seen to require a reversal of the normal burden of proof, so that a potential actor would need to prove that a proposed activity would not cause harm before it can be sanctioned. In short, it proposes the prospect of a utopian risk free life, and as such it is not only un-human but potentially counter-productive in the environmental, economic and social spheres.

- In assessing whether the new accession countries of Eastern and Central Europe were ready for entry, the European Union stressed the importance of not engaging in “merely formal transposition of legislation,” but rather “establishment of adequate structures for implementation and enforcement.” It was decided that these countries should at once begin to reproduce in their own laws both the legislation and the enforcement mechanisms already in place within the existing European Union.
- Today, the costs of converging environmental protection within all new former communist member states of the European Union are becoming increasingly clear for all to see. The cost of the Czech Republic’s compliance with European Union regulations has been estimated at more than 1.1 percent of gross domestic product. With Czech gross domestic product per capita being comparable to that of the other post-communist new member states of Central and Eastern Europe – Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia – it is possible to take the whole population of these countries at around 70 million and to extrapolate a total cost of around \$560 million across the whole region.
- The International Institute for Applied Systems Analysis now puts the transition costs between 1.6 per cent of GDP per year for Slovenia to 3.2 per cent of GDP per year for Poland.
- However, even these costs do not take into account the impact of compliance on economic activity. These are considerably greater. The post-communist new entrant states are much poorer than the western 15 member states. Gross domestic product per capita in the United Kingdom, for example, is \$28,350. In the Czech Republic, it is \$6,740. In Slovakia, it is lower still, at \$4,920. Regulatory compliance costs which are seen as a burden in the fourth richest country in the world will have a much greater impact in countries that are, in terms of national wealth, barely above the developing world.
- Looking at the total cost of compliance, rather than the annual cost, figures vary greatly from country to country. The most serious case is that of Estonia, where costs estimates attain some 70.4 per cent of Estonia’s GDP in 2001.
- In Poland, government officials estimate that the total investment needed to the country’s meat plants into compliance with EU regulations will be about \$900 million per year. The Polish Agency for Reconstruction and Modernisation is providing some subsidised credit, but the bulk of the required capital will have to come from the plants’ own profits or from foreign investors. When the full impact of entry to the European Union is felt, hundreds of smaller plants are expected to close.

- In Estonia, oil shale provides over 75 per cent of the country's total energy supply, making it the only country in the world where oil shale is the primary source of energy. This is produced by the state-owned Eesti Põlevkivi (Estonian Oil Shale) in the northeast portion of the country near Kohtla-Järve. It is consumed for power generation by the Eesti Energia and Kohtla-Järve Soojus electric companies and for shale-to-oil processing by Kiviter AS. Eesti Põlevkivi forecasts a significant drop in production after 2006, as the country begins to implement European Union regulations on pollution from the oil shale industry. This will lead to a direct rise in unemployment in the energy sector, and to increased costs throughout the economy, as factories and other energy users convert existing plant to deal with other fuels. No one knows what the full costs of compliance will finally be.
- In reality, the cost of compliance with all European union regulations has been imposed almost wholly on the new member states. Since 1989, Germany has spent about €600 billion on its eastern lander since unification, with Brussels supplying another €28 billion. For Austria, Finland and Sweden, the EU set aside €1.5 billion for their enlargement costs when they joined. For the 10 new member states, the European Union has budgeted €35 billion, net of contributions, between 2004 and 2006. These countries have been left to sink or swim by themselves.
- With hundreds of thousands of jobs now at stake in Central and Eastern Europe, there has already been a huge adverse impact. For example, in April 2004, the Government of the Czech Republic closed 81 food companies, mostly involved in meat production – because they violated European Union health and environmental regulations. Today, fears are rightly being expressed across the region that the situation is set to worsen. According to Anna Osmushkina, Latvia's leading fashion designer: *“Latvia is very weak and is not fully ready to join without problems. Financial support from the EU will not be enough for Latvian companies to quickly adapt to European regulations and many local companies will go bankrupt.”*
- While many of the Central and Eastern European accession countries have a good overall record in the transformation from command to market economies, they are mostly carrying an already high burden of unemployment. The environmental regulations now being imposed will make this situation even worse.
- Overall, the accession countries of Central and Eastern Europe have made remarkable progress since 1989. For the Centre for the New Europe it would be an ironic tragedy if entry to the European Union, which was one of the chief motivations for the reform process, should turn out to be the chief cause of arrested progress now that it has been achieved.

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1. The Recovery of Central and Eastern Europe

One of the great success stories of the past generation has been the recovery of the nations of Central and Eastern Europe from half a century of Communist rule. Immediately after the 1989 revolutions, it was apparent that their economies were not very far from collapse. They had been planned as an integral part of the Soviet war machine. The sectors dealing with private consumption had been starved of investment. Above all, there had been no attempt at market rationality in any sector. Not only were there no market prices for goods and services, but there were no ready means available to establish costs or any other kind of value chain analysis. There was no working law of contract, and no clarity of property titles. There were no domestic capital markets, and there was very little remaining knowledge among the people of how to make any private legal and market institutions work that might be established by the authorities.

Some of these countries had, before the Second World War, been among the most highly developed in Europe. Czechoslovakia, for example, had been as late as 1948 the 11th richest country in the world, with the largest accumulation of industrial capital between Germany and the eastern edge of the Eurasian landmass. In 1989, it was a semi-bankrupt rust belt. Its companies were poorly managed, under-capitalised, and organised to produce goods that very few people, given any choice in the matter, wanted to buy.

Added to all this were serious environmental problems. In any market economy, there is some approximation of costs to the value of output. This is either inherent to the process of private enterprise, where most costs are routinely borne by producers, or is roughly achieved by a combination of bad publicity for those who grossly externalise their costs and regulation by a reasonably impartial state machinery. In the communist countries, as said, there were no ways inherent to the production process to know, let alone apportion costs; and a controlled media and the blurring of production and regulation in the hands of one monopoly source of power ensured that the external controls normal to a free country were wholly lacking. Industrial towns – and communism was obsessed with industry – were as dirty and almost as unhealthy as the worst industrial slums of the western countries in the 19th century.

Some observers doubted if there could ever be a full recovery from the ravages of communism. John Gray, for example, predicted that the introduction of western-style market capitalism would result in further impoverishment and destabilisation.¹ Will Hutton, writing in 1991, was more gloomy still:

The tragedy is that Eastern Europe and the Soviet Union have become a vast laboratory for an experiment that we know cannot work. Nor can we be indifferent. As millions start to flee economic and social collapse we shall all feel the consequences. A classical legacy: a classical mess.²

¹ Ben Rogers, "Gray matter", *The Independent*, London, 29th October 1995.

² Will Hutton, "Time to blow the whistle on Karl and Adam", *The Guardian*, London and Manchester, 14th October 1991,

By the end of the century, much remained to be done. But the fundamentals were in place for sustained recovery. Privatisation was largely complete. There were flourishing domestic capital markets, and clearly established legal frameworks to establish property titles and to enforce contracts. States had largely disengaged themselves from the day to day management of micro-economic activity, and had become, or were well on the way to becoming, normal European states, concerning themselves mostly with the collection of taxes to provide common services. There was a flood of direct investment – at \$29 billion in 2002, larger per capita than China receives³ - that was transforming economic structures and taking advantage of rising consumer demand. And there were growing and increasingly self-confident classes of native entrepreneurs.

2. Case Study: The Slovak Republic

To see the scale of what has been achieved, let us take what is perhaps the weakest of the Central European states, which is the Slovak Republic. Poland, the Czech Republic and Hungary arrived at the middle of the 1990s with clear advantages. Either they had radical, reforming governments to drive the transformation process forward, or they had survived the Communist period with certain retained market structures. But Slovakia had none of these. It had been one of the most heavily socialised parts of the Soviet Empire in the region. Its industry was nearly all developed under Communist rule, and was largely adapted for weapons manufacture. It had even been groomed for a while in the 1970s for formal admission to the Soviet Union as one of its member states. On the 1st January 1993, it had divided from the Czech Republic, and spent much of the next decade under the rule of Vladimir Meciar, a populist who was instinctively hostile to market reform, and whose period in office was characterised by the more or less ruthless use of the security services to disrupt political opposition to his rule. When not ruled by him, the country suffered a succession of coalition governments that were held together more by dislike of him than by a common vision of Slovak progress to liberal democracy.

Even so, Slovakia made spectacular if delayed progress during the late 1990s. It restarted its transformation programme, and is now seeing the benefits. In an attempt to attract more investment, the Slovak Government in early 2004 reduced its tax on company profits and personal incomes to a flat rate of 19 per cent. Its industrial heritage has been turned to advantage. It is now being dubbed the “Detroit of Europe”. It has a Volkswagen factory producing 250,000 cars a year, and recently made a deal with Hyundai, the Korean company, to build its first European plant.

Slovakia also has a Samsung factory making printers and televisions, a Whirlpool factory making washing machines and one of the largest steel plants in Europe. By 2007, Slovakia, which has a population of five million people, will be producing 850,000 cars a year, making it by far the largest car producer in the world *per capita*. Forbes, the business magazine, recently called Slovakia an “investment paradise”, saying: “The Slovak Republic is set to become the world’s next Hong Kong or Ireland... a small place that’s an economic powerhouse.”⁴

Outside Bratislava, the Slovak capital, a new Volkswagen factory turns out 700 vehicles daily for export worldwide, including to Japan and America. The factory is one of the top three VW plants in the world, and produces almost a quarter of all Slovakia’s exports. “We are in

³ Gary Duncan, “Capital inflow to Eastern Europe hits \$29 billion high”, *The Times*, London, 5th September 2003..

⁴ Anthony Browne, “New industrial revolution begins in Eastern Europe”, *The Times*, London, 26th April 2004.

Central Europe, which reduces transport costs”, Thomas Schmall, one of the plant’s four directors, said. “These are really highly skilled people. The political risk is low compared with other states around here. The labour costs are one of the biggest advantages. If you put all the factors together, Slovakia is No 1.”⁵

3. The General Region

With extremely low wages and very low taxes, the Central and Eastern European countries are the most dynamic and open in Europe. Corporate tax rates in particular are low, making the area attractive for business relocation. Estonia has a zero rate, Hungary is on 16 per cent and Poland is lowering its rate to 19 per cent. By comparison, British corporate rates are 30 per cent and the average in the 15 eurozone countries is 33 per cent. In April 2004, Merrill Lynch, the merchant bank, extolled the virtues of Eastern Europe, saying: “Hard to see why a Japanese car manufacturer or a US chip producer would ever set up manufacturing operations in Western Europe. Prepare for a rapid acceleration in the de-industrialisation of Western Europe.”⁶

4. Entry to the European Union

One of the motives driving these processes of transformation forward was the goal of joining the European Union. In part, this was a sentimental goal. It was seen as the final step back into normal European civilisation. It was a definitive turning away from the East. In part, it was a matter of economic and political calculation. The 15 member states of the European Union already constituted the largest and richest trading bloc in the world. Membership would bring open and equal access to all European Union markets, and would automatically bring the new member states the advantage of established free trade agreements with the rest of the world. It would increase the confidence of foreign investors in the stability and profitability of whatever projects they started.

All through the 1990s, it was considered a scandal that the European Union had not granted immediate membership of at least the Central European states after the fall of Communism, and that they were forced to spend nearly a decade in a queue that included Turkey and the two halves of Cyprus. But serious negotiations on entry started in 1998, and Poland, Hungary, the Czech Republic and Slovakia, together with the three Baltic States, were among the ten new member states admitted on the 1st May 2004. In the various referenda on membership, there was no doubt of the outcome, and entry was attended with outbreaks of genuine popular enthusiasm. Today, all through these new member states, the European flag is placed beside all purely national emblems on public buildings.

5. Problems of Entry

The European Union, however, is not just a free trade association within Europe. Nor is it even just a place within which the various families of Europe can come together and live in peace and friendship. It is also an international body similar in nature to a federal state. Its basic constitutional documents talk about “an ever closer union” between the member states, and this is to be brought about by coordination from the centre. It has its own representative institutions and central directorate and code of laws. These are supreme throughout the

⁵ Anthony Browne, “New industrial revolution begins in Eastern Europe”, *The Times*, London, 26th April 2004.

⁶ Anthony Browne, “New industrial revolution begins in Eastern Europe”, *The Times*, London, 26th April 2004.

European Union, and one of the leading principles of the European Union is that its own laws are supreme and that they accordingly prevail in any conflict with those of the member states.

This fact should in itself not be seen as any overriding difficulty. In any state, sovereignty must be located somewhere. In a federal state, it makes some administrative sense for sovereignty to be located at the highest level. There may be objections to the principle of belonging to the European Union. But, granting that membership is a desirable end, there can be no reasonable objection to giving the central authorities wide authority to coordinate the local institutional arrangements so that they do not too greatly conflict with each other.

The difficulty must be the way in which sovereignty is exercised. Since 1992, the European Union has had in fact a single market – and had this in principle for many years before. Whatever goods and services may be freely traded in any one-member state cannot – with a few exceptions - be excluded from any other member state. This single market could have been brought about by the common recognition of national standards, so that the practice of the more liberal member states was followed elsewhere. Instead, the principle is that harmonisation should be brought about from the centre, and that there should be a common framework of laws and regulations which may be considerably more restrictive than those of any one member state.

The view prevailing within the European Union centres around concepts of the ordered market, rather than of the free market, and the idea of regulated competition, rather than free and open competition. Sometimes the focus will be on regulation in the name of the social market - for example in respect of labour market measures - at other times on reducing the costs of transactions in the Single Market - for example in the Financial Services Action Plan - and sometimes on risk reduction - for example in the areas of health and safety, consumer protection and the environment. The overall thrust is generally not on deregulation or getting rid of regulation but on how to achieve better regulation.

Thus, there are common standards, actual or proposed, of taxation and corporate organisation, of consumer protection, of health and safety, and of environmental protection. These are in the form of directives, which require national laws to be made of a particular kind, and of various direct regulations and binding decisions. Taken together, these laws fill about 85,000 pages, and constitute every legal instrument made since the 1950s. They cover everything from the minimum rate of value added tax to the recycling of refrigerators. They are collectively known as the *Acquis Communautaire*. Indeed, the Treaty of Athens, signed in March 2003, that formally accepted the new member states, itself runs to 4,800 pages in English. This whole library of often highly complex legislation has been built up over two generations. For the 15 western member states, there have been long periods of familiarisation with all this, and often long periods of derogation during which they could adapt to the new condition. The ten new member states were required as a condition of joining to accept every single page of this *Acquis Communautaire* – and to accept it in total on the day of joining.

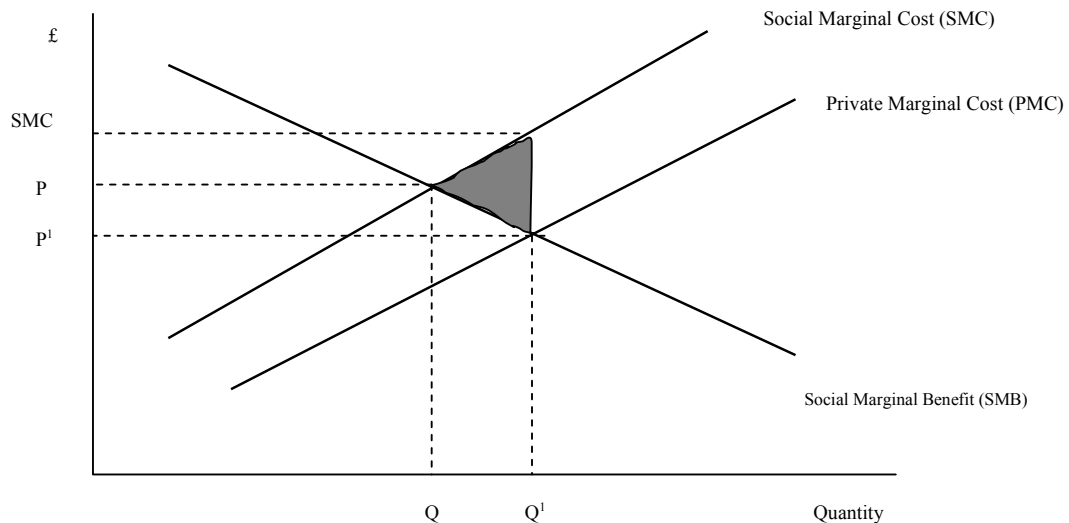
6. Environmental Regulation

Among the most prominent parts of the *Acquis Communautaire* is the weight of European environmental regulation. This has no basis in the original treaties setting up the European Union. However, since the 1970s, the European Union has taken an increasing interest in all areas of environmental regulation.

This is largely the result of a heightened awareness outside the area of pure economic analysis of external cost. Since the 1930s, when the concept of market failure was first systematised, there has been extensive discussion of this problem. Let us suppose, as illustration, that a paint manufacturing company generates a certain amount of chemical waste. By paying to have this taken away and treated, it will increase its costs beyond what they would be were it simply to dump the waste in a nearby river. If it takes the latter option, however, there is a chance that the waste will interfere with other human uses of that river – fishing, let us say, or the drawing of water for a town located downstream. In this case, the paint company will have externalised its costs. It will have avoided paying the whole costs of producing its output, but will have imposed them on others – and the costs thereby imposed on others may be far greater than the initial cost of chemical treatment.

This analysis can be widened to almost any economic activity. It is the basis of agitation over acid rain, over global warming as an alleged result of carbon emissions, over alleged depletion of the ozone layer, and much more. The externality does not have to be chemical pollution – though this is what generally receives most discussion. It can be noise or the simple location of processes that, clean in themselves, ruin areas of natural or other beauty, thereby resulting in loss of amenity.

Assuming that all costs and benefits can be known – which in the real world is an unlikely assumption – we can express this analysis in the form of a diagram:



The curve SMC expresses the whole cost of production. As it intersects with the curve SMB, it shows the price and output relationship that would exist if all costs were internalised to the firm. In fact, some costs are externalised, so that the actual cost of production is shifted to the right to the curve PMC. Therefore, the actual price and output relationship gives a lower price and higher output than would otherwise exist. The shaded triangle shows the deadweight loss created by the resulting externality.

It is to deal with this problem of external cost that the European Union has legislated on environmental issues. Today, environmental protection is firmly established in the various treaties. Some 200 pieces of legislation have been adopted and are in force, concerned chiefly with minimum standards for waste management and water and air pollution. These have been enforced with increasing enthusiasm; and around 90 per cent of all new environmental rules

introduced in member states originate from the European Union. There are now laws on everything from the avoidance of climate change to the recycling of wine bottles.⁷

The basic principles of European Union environment protection law are: precaution, prevention, liability for damages, cooperation, and access to information. These principles were clarified and extended by various directives following the the Århus Convention, the full title of which is Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters, adopted by The UN Economic Commission for Europe (UNECE) in June 1998 in the Danish city of Aarhus (Århus) at the Fourth Ministerial Conference in the “Environment for Europe” process. It entered into force on 30 October 2001⁸. It was followed by the passing of various directives and regulations.⁹

The precautionary principle asserts that in cases when serious harm is threatened, positive action to protect the environment should not be delayed until irrefutable scientific proof of harm is available. It assumes that certain economic activities will always produce external costs. It represents a new legal principle. In its strongest formulations this principle can be seen to require a reversal of the normal burden of proof, so that a potential actor would need to prove that a proposed activity will not cause harm before it can be sanctioned.

Related to the precautionary principle is the concept of environmental impact assessment, which is based on the premise that environmental planning requires full information. European Union law requires that relevant decisions are preceded by environmental impact assessments, to take into account the costs of any ecological consequences and to integrate environmental considerations in decision making at all levels.

These environmental impact assessments have been strengthened by the evolution of the right of access to information on the environment and the right of public participation. European Union law increasingly insists that environmental issues are best handled with the participation of all concerned parties. It requires the relevant organisations: (a) to make environmental information available as soon as possible, and without an interest having to be stated by the requester; (b) to take specific measures to ensure complete public participation in decisions of specific activities, plans, programmes, policies, and other regulations related to the environment; and (c) to ensure that any person who feels that the state has not met specific environmental commitments has access to a review procedure before a court.

A further principle of European Union environmental regulation is that the costs of pollution should so far as possible be borne by the party responsible. The practical implications of this principle lie in its allocation of economic obligations in activities allegedly harmful to the environment. The overriding objective is to ensure that external costs are avoided – that they should so far as possible be internalised.

⁷ In 1998, the European Commission published a *Guide to the Approximation of European Union Environmental Legislation*. This is Annex 2 to *The Environmental Acquis* in force 6 March 1998. It is available at <http://europa.eu.int/comm/environment/guide/annex2.htm> - checked November 2004.

⁸ Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters, The UN Economic Commission for Europe (UNECE), 1998; available at: <http://europa.eu.int/comm/environment/pdfinfo.htm> - checked November 2004.

⁹ For a summary of these, see the European Union website: <http://europa.eu.int/comm/environment/aarhus/#news> – checked November 2004.

7. Costs of Regulatory Compliance

Few might argue against the principle of environmental protection. Undoubtedly, the emergence of large-scale industrial activity since the 18th century, and the great increase in population and in its expectations, have led to unprecedented changes in the human and natural environments. Many industrial processes do result in environmental degradation. These may have an immediate impact on health and general welfare. Others may have a delayed impact that may be greater still. It may be doubted if all specific claims of degradation are based on sufficiently good evidence. But there is an environmental problem of sorts.

This being said, much action to avoid external costs has costs of its own. If wine bottles are to be recycled, someone must pay for them to be collected and reused. If carbon emissions are to be reduced, someone must pay for more efficient fuels and more efficient uses of fuel. If waste is not to be dumped, someone must pay for it to be taken away and treated. These costs may not fall only on the producer. In some cases, the cost of dealing with production externalities may greatly outweigh the cost of preventing them – in which case environmental protection can be justified as a saving even in the short term. Nevertheless, there are usually net costs. There are direct costs, looking only at the avoidance of harmful activities. But there are also the indirect costs in terms of financing the regulatory agencies charged with overseeing compliance, and in terms of setting up programmes within business to ensure compliance. Then there are the future opportunity costs of regulation. It is often easy to guess the external costs of any proposed activity: it is far harder to guess the benefits, though these may be considerable. Taken together, these can be substantial costs.

In July 2004, for example, the Confederation of British Industry, which represents big business in Britain, complained about the mounting cost of compliance with environmental regulations – the great majority of which, as said, come from the European Union. Apparently compliance costs were now running at £4 billion per year. A survey of members showed that environmental legislation was considered the second most worrying concern after employment rules. According to John Cridland, the Deputy Director-General.:

Too much environmental regulation is badly designed and poorly implemented. We are not anti-regulation or against rigorous enforcement but we make no apology for complaining about sloppy laws that are implemented poorly and enforced in an ill-considered fashion.¹⁰

And these were only the costs that could be easily quantified. There was no attempt made to calculate all the opportunity costs in terms of future production foregone.

As an example of these regulations, take European Union Regulation 2037/2000, which came into force on the 1st January 2001. This was designed to prevent the escape of ozone-depleting chlorofluorocarbon (CFC) gases, and it made it a criminal offence to recycle refrigerators and freezers.

Each year three million of these become surplus to requirements in Britain alone. Until the Regulation came into force, 99 per cent, taken in part-exchange, were turned into scrap or reconditioned by specialist firms to meet a huge export demand from poorer countries. Then, following the assignment of the Regulation unopposed by the European Parliament's

¹⁰ Terry Macalister, "CBI says 'sloppy' environmental laws are costing industry £4bn a year", *The Guardian*, London and Manchester, 5th July 2004. The report itself is not available on the Internet.

environmental committee, unwanted refrigerating equipment was classified as hazardous waste and the only legal way to dispose of them was to take them at great expense to specially licensed plants, where the gas could be extracted and the rest incinerated.

There were at the beginning only two such plants in the European Union, in Holland and Germany, both already working to capacity. There was thus no legal means to dispose of three million machines a year in Britain, which had now to be stored until the Government could work out what to do with them. Customers could no longer hand them over in part-exchange. Inevitably, many were illegally dumped on roadside verges or in skips. The result was to substitute one kind of pollution for another, and to increase costs for all those involved in keeping the countryside looking clean.

Again, take the European Emissions Trading Scheme, which is a highly bureaucratic set of regulations to achieve the Kyoto targets of cutting carbon emissions by 8 per cent. It will set up a market in pollution, with each company in the market given a certain quota of pollution – a quota that can be traded. This comes into force in 2005. According to Michael Cupit, director of emissions at Ernst & Young, gas prices could rise by 20 per cent over the two years following the introduction of the new scheme. Wholesale electricity prices are expected to rise by 15 per cent. He adds:

Large energy users such as steel mills and paper mills will feel the brunt of these, though consumers may be protected if the worst of the price rises are absorbed by the generators.... Without tight, clear and consistent rules being in place, the scheme will not function as intended and may even do more damage than good to the environment¹¹

8. Environmental Protection in the Post-Communist New Member States

Now, these complaints apply to Britain. But the full weight of European Union environmental protection also applies in the new member states of Central and Eastern Europe. As said, these had at best limited schemes of environmental protection during the communist period. The adoption of European Union environmental regulations, therefore, had almost as great an impact on these countries as the transformation to a market economy.

In assessing whether these countries were ready for entry, the European Union stressed the importance of not engaging in “merely formal transposition of legislation,” but rather “establishment of adequate structures for implementation and enforcement.”¹² In July 1997, the Commission presented Agenda 2000, the first comprehensive assessment of countries applying for membership in the EU. Agenda 2000 devotes a significant portion of its discussion to progress in non-economic policy areas, including environment. Generally, it noted that the proposed new entrants were focussing more on dealing with the problems on environmental damage, whereas the European Union favoured prevention at source. These policies generally relied on fines as an enforcement mechanism, but the fines were often set so low that they did not function as incentives to reduce pollution. There was in consequence a tendency for industries to budget for the fines imposed for non-attainment of standards, rather than for them to attempt to reduce pollution. It was also noted that the authors of environmental legislation were unused to including a compliance strategy or timetable, and

¹¹ Quoted in Angela Jameson, “Energy prices ‘will rise’ under emissions plan”, *The Times*, London, 17th June 2004.

¹² European Commission, Agenda 2000 (EU DG1A, 1997 [cited 16 July 1999]); available from: http://europa.eu.int/comm/dg1a/enlarge/agenda2000_en - checked November 2004.

thus while good principles might exist on paper, there were no concrete plans to implement them.¹³

It was decided that these countries should at once begin to reproduce in their own laws both the legislation and the enforcement mechanisms already in place within the existing European Union. Special attention was emphasised to the introduction of the basic European Union guidelines relating to water and air protection, and waste disposal into the legislation of the laws of the proposed new member states. The environmental regulations that the accession countries must adhere to in order to meet the membership criteria of the European Union amount to over 300 different laws that include standards for air, waste, water, industrial pollution control and risk management, nuclear safety and radiation protection.

There has been no study made so far of the costs of converging environmental protection within all the new member states of the European Union, nor even of convergence costs within the post-communist member states. However, various studies were made in the late 1990s for the Czech Republic, which was always – in social and political as well as in economic terms – one of the most highly developed of the Soviet satellite states. Indeed, it was always something of an anomaly within the Soviet bloc, being at heart more western than countries such as Greece and Portugal. Even before the break with Slovakia, it had adopted one of the most enthusiastic reform programmes, and Prague was on its way to becoming a regional financial and general service centre.

In 1997, Jan Mikolas, Director of the Environmental Management Office s.r.o., a private consultancy based in Prague, made a rough calculation of the cost of compliance with European Union environmental regulations. Costs are given in Czech Crowns (Kč), which have held their value against western currencies reasonably well over the past decade, and which stood in November 2004 at around 25 to the US\$. The predicted costs went as follows:¹⁴

Annual increase in baseline costs in Kč	
State administration:	
(salaries, operational and investment costs of strengthening the system)	72 million
Waste management facilities:	
increase is not expected	
Specific kinds of waste:	
Neutralization of waste oils – construction of a used mineral oil regeneration facility	40 million
Packing material waste:	
Creation of foundations for a system of collecting and recycling packing material waste	150 million
Total	262 million

¹³ Gyula Bandi, “Competence and Harmonization Problems in Hungary”, 9 *Connecticut Journal of International Law* 607 (1994).

¹⁴ Taken from Jan Mikolas, *Costs Connected with European Union Application in the Waste Management Sector in the Czech Republic*, Prague, 1997; available at: http://www.mpo.cz/xqw/webdav/-UTF8-/dms_mpo/getFileinternet/10554/6879/s9803/page0004.htm - checked November 2004.

Annual increase in incremental costs in Kč	
State administration:	
(salaries, operational and investment costs of the establishment of a professional body)	62 million
Waste management facilities:	
Reconstruction of hazardous waste incinerating plants to achieve EU limits	70 million
Construction of a municipal waste incinerating plants, and 7 biowaste compost plants to reduce biowaste dumping	380 million
Specific kinds of waste:	
Creation of a system of collecting and storing waste oils	70 million
Creation of a system of collecting and storing hazardous parts of municipal waste	70 million
Neutralization of PCB waste - construction of a hazardous waste incineration plant	375 million
Packing material waste:	
Creation of a developed system of collecting and recycling packing material waste	600 million
Total	1 625 million

Let us round this figure to 2,000 million Kč, which will take inflation into account. Converted into Dollars, it makes \$80 million – or just over 1.1 per cent of the Czech gross domestic product (of \$6,884 million as of 2004). Now, the Czech gross domestic product per capita is comparable to that of the other post-communist new member states of Central and Eastern Europe – Estonia, Hungary, Latvia, Lithuania, Poland, and Slovakia. If we take the population as a whole of these countries, as around 70 million, we can extrapolate these total costs to around \$560 million across the whole region.¹⁵

These estimates are supported by the independent calculations of Dominika Anna Dziegielewska, at the International Institute for Applied Systems Analysis. She puts the transition costs between 1.6 per cent of GDP per year for Slovenia to 3.2 per cent of GDP per year for Poland.¹⁶

Looking at the total cost of compliance, rather than the annual cost, figures vary greatly from country to country. The most serious case is that of Estonia, where cost estimates attain some 70.4 per cent of Estonia's GDP in 2001.¹⁷

But these projections are barely a fraction of the probable total. In April 2001, it was revealed that these countries had been told to spend an estimated €30 billion simply to meet the European Union's waste water standards before they could join.¹⁸

¹⁵ Population and other statistics taken from *Internet World Stats: Usage and Population Statistics*; available at <http://www.internetworldstats.com/europa.htm#cz> – checked November 2004.

¹⁶ Dominika Anna Dziegielewska, *How Much Does It Cost To Join The European Union And Who Is Going To Pay For It? Cost Estimates For The Czech Republic, Hungary, Poland And Slovenia, Complying With The EU Environmental Standards*, International Institute for Applied Systems Analysis, January 2000; available at: <http://www.iiasa.ac.at/Publications/Documents/IR-00-001.pdf> - checked November 2004.

¹⁷ David L. Ellison, *Politics and the Environment In Central Europe: Paper prepared for the 2004 Conference of Europeanists, Europe and the World: Integration, Interdependence, Exceptionalism*, Chicago, March 11-13th, p.16; available at: http://www.europenet.org/conference2004/papers/G6_Ellison_revised.pdf - checked November 2004.

¹⁸ Martin Fletcher, "Britain tops EU's dirty cities chart", *The Times*, London, 19th March 2001.

These costs do not take into account the impact of compliance on economic activity. These are considerably greater. The post-communist new entrant states are much poorer than the western 15 member states. Gross domestic product per capita in the United Kingdom, for example, is \$28,350. In the Czech Republic, it is \$6,740. In Slovakia, it is lower still, at \$4,920.¹⁹ Regulatory compliance costs which are seen as a burden in the fourth richest country in the world will have a much greater impact in countries that are, in terms of national wealth, barely above the developing world. Even taking in Cyprus, Malta and Slovenia, gross domestic product per capita is less than 40 per cent of the European Union average. Their total gross domestic product is about the same as that of Holland.²⁰

Staying with the Czech Republic, we can see a substantial impact. In April 2004, the Government of the Czech Republic closed 81 food companies, mostly involved in meat production – because they violated European Union health and environmental regulations.²¹ Among much else, these environmental regulations require plants to have water purification systems. The closures were ordered after an inspection by European veterinary services. According to Czech Veterinary Administration spokesman Josef Duben:

An EU mission visited the Czech Republic in January and as a result of that we decided to carry out stricter controls, which led to the closure of 81 companies.²²

A further seven companies were closed. Since the beginning of 2003, a total of 586 food companies, which did not conform to European Union's environmental and health regulations, had been closed in the Czech Republic. A large number of the companies were meat processing plants. Another 3,000 companies, most of them smaller enterprises, were able to sell their products only in the local market. Dr Duben Added:

The essential factor is their production capacity.... But small factories which want to take part in the common market will have to respect stricter norms that also apply to larger companies.²³

Turning to Poland, government officials estimate that the total investment needed to bring Poland's meat plants into compliance with these regulations will be about \$900 million per year. The Polish Agency for Reconstruction and Modernisation is providing some subsidised credit, but the bulk of the required capital will have to come from the plants' own profits or from foreign investors. When the full impact of entry to the European Union is felt, hundreds of smaller plants are expected to close.²⁴

Turning to Estonia, oil shale provides over 75 per cent of the country's total energy supply, making Estonia the only country in the world where oil shale is the primary source of energy. This is produced by the state-owned Eesti Põlevkivi (Estonian Oil Shale) in the northeast portion of the country near Kohtla-Järve. It is consumed for power generation by the Eesti Energia and Kohtla-Järve Soojus electric companies and for shale-to-oil processing by Kiviter AS.

¹⁹ Source: *Internet World Stats*

²⁰ Source: Steven Castle, "The New Europe", *The Independent*, London, 10th October 2002.

²¹ "Food Plants Closed", *Meatnews.com*, 12th April 2004; available at: <http://www.meatnews.com/index.cfm?fuseaction=article&artNum=7282> – checked November 2004.

²² *Ibid.*

²³ *Ibid.*

²⁴ *Agricultural Outlook*, January/February 2002; available at: <http://usda.mannlib.cornell.edu/reports/erssor/economics/ao-bb/2001/ao288f.txt> - checked November 2004.

Eesti Põlevkivi forecasts a significant drop in production after 2006, as the country begins to implement European Union regulations on pollution from the oil shale industry. This will lead to a direct rise in unemployment in the energy sector, and to increased costs throughout the economy, as factories and other energy users convert existing plant to deal with other fuels. No one knows what the full costs of compliance will finally be.²⁵

In general, it is expected that the major impact of compliance with the environmental *acquis* will fall on the heavy chemical sector. Many plants are old and inefficient and characterised by poor energy efficiency, over-employment and a product profile that largely reflects the original markets the plants were built to serve. Moreover, few firms have access to the financial resources needed to invest in new production technologies nor, so far, have they been able to attract strategic investors who might be able to provide such investment. Again, compliance costs cannot be quantified, or job losses, but a survey by Price Waterhouse Coopers estimates that they will be substantial, and may have some effect on employment in the sector.²⁶

We cannot extrapolate these closures across the economies concerned, and certainly not across all of the ten countries under consideration. But they can stand as an illustration of the costs of regulatory compliance.

Fears are expressed across these countries. According to Anna Osmushkina, Latvia's leading fashion designer:

Latvia is very weak and is not fully ready to join without problems. Financial support from the EU will not be enough for Latvian companies to quickly adapt to European regulations and many local companies will go bankrupt.²⁷

As said, these are relatively poor countries. While they have a good overall record in the transformation from command to market economies, they are mostly carrying an already high burden of unemployment. In 2004, their gross rates of unemployment were as follows:²⁸

EU15	8.0 %
Czech Republic	8.0 %
Estonia	9.5 %
Hungary	5.9 %
Latvia	10.5 %
Lithuania	11.7 %
Poland	19.1 %
Slovak Republic	16.6 %

Moreover, the costs of compliance with all European union regulations has been imposed almost wholly on the new member states. Since 1989, Germany has spent about €600 billion

²⁵ Source: *Estonia Energy*, 2001; available at: <http://archive.wn.com/2004/11/18/1400/estoniaenergy/> - checked November 2004.

²⁶ *Winning Strategies For Locally-Owned Businesses In Central Europe*, PricewaterhouseCoopers LLP, London, 2000; available at: [http://www.pwc.com/Extweb/pwcpublishations.nsf/4bd5f76b48e282738525662b00739e22/3b1429b14e19c70580256d43004c1abf/\\$FILE/Winning%20strategies.pdf](http://www.pwc.com/Extweb/pwcpublishations.nsf/4bd5f76b48e282738525662b00739e22/3b1429b14e19c70580256d43004c1abf/$FILE/Winning%20strategies.pdf) - checked November 2004.

²⁷ Quoted in Ed Vulliamy, "The new Europe", *The Observer*, London 11th April 2004.

²⁸ Source: Kate Bishop, *Employment and unemployment in the new EU member countries*, Office of National Statistics, London, 1994; available at: http://www.statistics.gov.uk/articles/labour_market_trends/EU_member_countries.pdf - checked November 2004.

on its eastern lander since unification, with Brussels supplying another €28 billion. For Austria, Finland and Sweden, the EU set aside €1.5 billion for their enlargement costs when they joined. For the 10 new member states, the European Union has budgeted €35 billion, net of contributions, between 2004 and 2006.²⁹ These countries have been left to sink or swim by themselves.

These countries have made remarkable progress since 1989. It would be ironic if entry to the European Union, which was one of the chief motivations for the reform progress, should turn out to be the chief cause of arrested progress now that it has been achieved.

9. A Hidden Agenda?

In the long term, all parties to international trade benefit. The result of international trade is greater specialisation, as in each nation those sectors expand that are best suited to its endowment of particular factors of production. However, there are always losers in the short term. There are those sectors already existing in a country that turn out not to be viable when markets are opened to foreign competition. In the western 15 member states of the European Union, there has been a loss of industrial production and of low level administration to the new member states.

For example, in January 2004, Philips, the Dutch electronics company, moved 150 administrative jobs from Dublin to Poland.³⁰ In the same month, closed its manufacturing base in Teeside. It could no longer justify hourly wage rates of £5.60 in northern England. The move followed similar decisions by Motorola, Nortel, Panasonic, NEC, Ericsson, Black and Decker, Lucky Goldstar, Compaq, Sony and Hitachi. Even Nissan - a successful Japanese investor in Britain - was complaining about its cost base and the price of credit, suggesting that it might manufacture a replacement for the Almera elsewhere. Slovakia, with average hourly wage costs of around £1, was among the favoured destinations.³¹

Up to 2.5 million workers are employed by German companies outside Germany; many of these jobs are being created in Poland, Hungary, the Czech Republic and Slovakia. Car companies, computer chip manufacturers, clothing factories and engineering businesses are among those moving. Lower wage rates plus the lighter burden of regulations and corporate taxes are tipping the balance away from the Western 15 member states.

Faced with a possibly considerable loss of jobs, political leaders in the western 15 member states have responded with public complaints. Gerhard Schroder, the German Chancellor, said in April 2004:

Such policies do not allow them [the new member states] to finance their infrastructure projects from their own sources, leading to co-financing from Brussels. Thus at the end of the day, problems have to be shouldered by EU members, which we just cannot abide.³²

The previous month, he had gone further, denouncing wealthy German businessmen who invest in Eastern Europe and drain jobs from Germany as “unpatriotic”. He was attacking Ludwig Georg Braun, the president of the German Industry and Trade Association, who had

²⁹ Figures from Rosemary Righter, “EU entry will cost Big Bang Ten too much”, *The Times*, London, 25th June 2002.

³⁰ Damian Kiberd, “Challenge set by new kids on the EU block”, *The Sunday Times*, London, 25th January 2004.

³¹ *Ibid.*

³² Anthony Browne, “New industrial revolution begins in Eastern Europe”, *The Times*, London, 26th April 2004.

recommended eastern investment. He was joined by Klaus Uwe Benneter, the new Secretary-General of the Social Democrats:

Braun is behaving as if he has no fatherland.³³

Goran Persson, the Swedish Prime Minister, said of the new member states:

If they believe that we will tax heavily in Sweden, Finland and Denmark and send the money to Eastern Europe, where the upper class does not pay taxes, this is not sustainable.³⁴

Bearing in mind these facts and these statements, it is legitimate to suspect that the insistence on acceptance of the whole *Acquis Communautaire*, including all environmental regulation, was part of an attempt to limit the impact of competition from the new lower cost market economies of central and eastern Europe.

10. Concluding Remarks

On the 9th November 2004, Václav Klaus, President of the Czech Republic, spoke in San Francisco to the Commonwealth Club of California and the World Affairs Council of Northern California. While he is well known to have been sceptical about the benefits for his country's entry into the European Union, a key section of his speech reads:

When we speak about enlargement, there is no doubt that the new members, Central and East European countries, gained an important political recognition, that their membership in the EU means an end of the post-communist transformation, as well as an end of the Cold War division of Europe. This is very important. These effects are, however, more symbolic than real.

The real problem is different. The new member countries – economically less developed countries – need **catching-up**. They need **real convergence**. The question is whether the nominal convergence, the acceptance of EU legislation, standards, rules, policies, will accelerate the expected real convergence or will block it? The historical evidence is in this respect – at least – mixed. The results depend very much on the existence or non-existence of huge financial transfers because – without them – the nominal convergence creates costs that are higher than the benefits. This problem should be taken seriously because, otherwise, we will be confronted with a huge disappointment of citizens in the new member countries.

Enlargement means a bigger EU and, as a result of it, **the transaction costs of EU functioning will go up**. On the one hand, the governing in a bigger and more diversified entity will be more complicated. I refer to the costs of collecting, using and evaluating the necessary information, the costs of making decisions in a multidimensional, very complicated structure, the costs of implementing and controlling decisions, etc. **When we increase the number of countries, keep the scope of policies constant, the governing will be either more costly or less efficient and/or less democratic**. To escape such an unpleasant arithmetic is not possible. At the same time, there will be non-zero costs for individual EU countries connected with their obligatory application of uniform EU decisions and standards.³⁵

These words apply to the whole of the European Union as it has developed in recent years. It applies with undiminished force to the burden of environmental regulation. Unchecked, this will blunt – or perhaps even end – one of the great success stories of the past generation.

³³ Roger Boyes, "Schroder berates unpatriotic bosses", *The Times*, London, 25th March 2004.

³⁴ Anthony Browne, "New industrial revolution begins in Eastern Europe", *The Times*, London, 26th April 2004.

³⁵ Václav Klaus, "*Czech Republic and the EU: The Marriage of Convenience, Not of Love*", Speech for The Commonwealth Club of California and World Affairs Council of Northern California, San Francisco, 8th November 2004; available at: <http://www.klaus.cz/klaus2/asp/clanek.asp?id=CIIjrk437LAG> – checked November 2004