The European Union: Eastern Enlargement and Taxation

M. PETER VAN DER HOEK*

Abstract

The European Union has not defined its limits in geographical terms. Each enlargement has led and will lead to a decrease of the European Union’s per capita GDP. After the collapse of the Soviet Union, the transition countries went through a long and deep recession. However, they have reached a stage of positive growth and their tax levels are approaching the lower limit of the range of tax/GDP ratios in European Union countries. Differences exist in tax capacity and tax effort. In some countries, greater efforts are possible to improve tax revenues. Further examination of the timing of tax administration reform may shed light on tax effort in transition countries. The paper also suggests the existence of a negative relationship between tax effort and corruption. (JEL P27, H20)

Introduction

It is quite common to talk about Europe, the European Union, Western Europe, Central and Eastern Europe, and South-Eastern Europe. However, it is not quite clear what most of these terms mean. The exception is the European Union, which is not a geographical notion but a well-defined political concept resulting from its membership of 25 countries (as of May 1, 2004). The other terms—Europe, Western Europe, Central and Eastern Europe, and South-Eastern Europe—are geographic rather than political in character and are less clear than they seem at first sight. For example, Israeli and Turkish football clubs participate in European soccer competitions. The Eurovision Song Festival also includes participants from Israel and Turkey. This suggests that Israel and Turkey are European countries. However, it seems likely that many people would not consider these countries part of Europe. Yet, Turkey is a candidate-member country of the European Union even though most of its territory is located in Asia [van der Hoek, 2003a, p. 44].

The European Union has not defined its limits in geographical terms. The Treaty on European Union says in Article 49 that “any European State which respects the principles set out in Article 6(1) may apply to become a member of the Union.” Article 6(1) states that “the Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law, principles which are common to the Member States.” The European Union has granted Bulgaria, Romania, and Turkey the status of candidate-member countries. Bulgaria and Romania are expected to join the European Union in 2007, whereas Turkey hopes to receive a preliminary entry year by the end of 2004. If so,

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this will most likely be a year in the mid 2010s. Moreover, the European Union has identified
the countries of the West Balkans region, including former Yugoslav republics, as potential
candidates.

The Copenhagen European Council has made the principles set out in Article 6(1) of the
Treaty on European Union more concrete. These so-called Copenhagen criteria comprise a
political criterion, an economic criterion, and the ability to take on the *acquis communautaire*:
1) Stability of institutions guaranteeing democracy, the rule of law, human rights, and
   respect for and protection of minorities;
2) The existence of a functioning market economy, as well as the ability to cope with
   competitive pressures and market forces within the EU;
3) The ability to take on the obligations of membership, including adherence to the aims
   of political, economic, and monetary union.

Enlarging the European Union

Following the definition used by the European Bank for Reconstruction and Develop-
ment (EBRD), this paper refers to regions in Europe that comprise the following countries:
Central and Eastern Europe: Croatia, Czech Republic, Hungary, Poland, Slovakia, and Slove-
nia; South-Eastern Europe: Albania, Bulgaria, Yugoslavia, Macedonia, and Romania; Baltic
States: Estonia, Latvia, and Lithuania; and Newly Independent States: the 12 former Soviet
Republics excluding the Baltic States.

Table 1 shows some basic characteristics of the ten accession countries in Central and
Eastern Europe in the mid 1990s, that is, at the time of their applications for European Union
membership. Their combined population amounted to 28 percent of that of the European
Union of 15 member states. However, their combined GDP amounted to only 4 percent of
that of the EU-15 at current prices, or 9 percent at purchasing power standards. GDP per
 capita in the applicant countries amounted to 13 percent at current prices or 32 percent at
purchasing power standards. Thus, the applicant countries are poor relative to European
Union member states. Though their population is sizeable, their economic weight is very
small.

<table>
<thead>
<tr>
<th>Area</th>
<th>Population</th>
<th>Total GDP (current prices)</th>
<th>GDP per capita (current prices)</th>
<th>Total GDP (purchasing power)</th>
<th>GDP per capita (purchasing power)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEE-10</td>
<td>33</td>
<td>28</td>
<td>4</td>
<td>13</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: European Commission, 1997, p. 68.

Figure 1 shows GDP levels in the individual accession countries in Central and Eastern
Europe and South-Eastern Europe relative to the European Union average, both in 1995
and 2002. It includes the level of the poorest European Union member state (Greece) as a
benchmark. Obviously, Slovenia is the richest of the accession countries, while Romania is
the poorest. However, relative positions changed considerably during the period 1995-2002.
Former Soviet republics, the Baltic States, which started the reforms at relatively low GDP
levels, showed the strongest growth. In 1995, Latvia was the poorest applicant country with
a per capita GDP of 18 percent of the European Union average in 1995, followed by Estonia
and Romania with a per capita GDP of 23 percent. In 2002, however, Estonia’s GDP per
capita had almost doubled to 42 percent of the European Union average, whereas Romania’s
per capita GDP had barely risen to 25 percent.