Decomposing the Economic Costs and Benefits of Accession to the EU: the Swiss Case

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Abstract

This paper proposes a decomposition of the likely effects of a “deep” regional integration arrangement for a small country. It is based on a steady-state general equilibrium model which allows to capture the long-term effects of a variety of factors, including the reduction of non-tariff barriers, immigration, budgetary transfers and monetary integration. Particular care is given to the modeling of wealth accumulation, with savings endogenized on the basis of an overlapping generation framework. The effects of product standardization in manufacturing are simulated on the basis of ex-post estimates of the pro-competitive effects of the Single Market Program.

• JEL Classifications: F12, F15, C68
• Key Words: Regional Integration, Applied General Equilibrium

I. Introduction

Since the refusal of the European Economic Area (EEA) treaty by the Swiss voters in 1992, the Swiss government followed a triple stage strategy to pursue integration with the European Union (EU). In the short run, it adopted a series of unilateral measures aimed at bringing Swiss regulations closer to European ones. In the long run, although it had to freeze its candidacy, it never abandoned mem-

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embership of the EU as its ultimate objective. In the medium run, a less ambitious partnership was negotiated with the EU whose obligations, known as the “Bilateral Agreements”, have been accepted by a Swiss referendum in May 2000. Although the debate goes beyond economic issues, it is of crucial importance to understand the economic consequences of these strategies. What are the likely economic effects for Switzerland of staying out, getting closer (through the bilateral agreements) or of joining the EU? This paper proposes a simulation model which identifies the various channels through which European integration is likely to affect resource allocation and welfare. Its distinguishing characteristic resides in the variety of effects that are incorporated in the model and the decomposition of these effects.

Several dimensions of the Swiss case make it particularly interesting, and applicable to other applicants for membership. First, Swiss protection is still considerable in the case of agricultural goods and food products. The adoption of the Common Agricultural Policy (CAP) in the case of EU accession would thus imply drastic changes in the protection of these sectors. Second, at present wage differentials, free labor movement would lead to a net immigration flow. This will have important consequences for both aggregate welfare and income distribution, depending not only on the total amount, but also on the skill composition of the immigrant population. Third, fiscal compliance with EU rules would mean an important contribution to the EU budget and a shift from direct to indirect taxation. Official estimates show that if the net transfer to the EU was financed by an increase of the rate of the value added tax (VAT) to the European minimum level, this would generate additional resources, allowing a reduction in the income tax rate. Fourth, a substantial increase in interest rates can be expected if Switzerland participates in the European Monetary Union (EMU). Indeed, the elimination of the exchange rate risk should make it impossible to maintain lower interest rates than in other European countries.

While not all of these effects necessarily concern countries seeking membership in the EU, they broadly apply to the new entrants of the recent enlargement and, to a lesser extent, they are also pertinent to countries like the Czech Republic, Hungary and Poland that are currently negotiating membership. Indeed, including the effects of the CAP, the VAT, as well as labor and capital mobility is necessary if one wishes to capture orders of magnitude of membership accession into a deep regional integration scheme. This paper proposes such a framework and applies it to the case of Switzerland.