Referee report on The Economic Effects of Croatia's Accession to the EU

This paper estimates the economic effects of Croatia's entry to the EU, using a computable general equilibrium model. Two kinds of effects are considered. First, by gaining full access to the internal market, the remaining barriers to trade will be eliminated which will, in turn, raise Croatia's trade with the EU. Second, Croatia can benefit also from institutional change instigated by its EU entry – in particular, from lower corruption that should result from its adoption of EU norms and legal rules.

The paper finds that the EU accession have translate into important gains for Croatia. Accession to the internal market is estimated to raise Croatian GDP by 1.1 percent. Furthermore, assuming that corruption in Croatia will fall to the level prevailing in Portugal, GDP will further increase by 7.8 percent. The accession of Croatia will bring about modest gains for the current EU members. However, given the small size of Croatia relative to the EU, the gains are so tiny that they are nearly not perceptible.

Comments:

(1) Section 2 describing the economic situation in Croatia and its progress towards securing EU membership is unnecessary. The section makes the paper appear more of a policy report than an academic article.

(2) The gains from trade envisaged in this paper are probably unduly optimistic. The literature looking at historical patterns of European trade suggests that regional preferential trade areas follow rather than only cause elevated levels of trade (see, for example, the NBER wp 5565 by Eichengreen and Irwin and CESifo wp 2246 by Heinemeyer et al.). In other words, countries that choose to liberalize their bilateral trade typically trade a lot with each other already before they form a preferential trade area. This partially explains why the EU effect on trade is relatively high, on average. Since Croatia historically did not have very strong trade relations with most of the EU countries, it is likely that its trade gains from EU membership will remain below the EU-wide average level also in the long term.

(3) Following up on the previous point, it would be instructive to look at the trade patterns of the 2004 entrants to the EU. The time that has elapsed is still rather short but some gains may have already been realized (NB: similar analysis has been carried out by Micco et al. for the effect of the euro in their 2003 Economic Policy article, also only a few years after the event in question took place).

(4) The gains envisaged due to institutional improvements are very arbitrary. There are vast differences in corruption levels across the

EU. A-priori, it is not obvious why Croatia should improve its corruption level to match Portugal rather than, for example, Italy or Greece. There are also important regional differences: for instance, all Scandinavian countries have similarly high corruption levels, Spain and Portugal are similar too, and so on. Again, on this account, one could expect that in the long term Croatia will look more like Italy or Greece rather than Portugal. And as before, can we observe any improvement in corruption in the 2004 EU entrants?
Furthermore, corruption is may improve in Croatia even without EU accession and therefore it is not obvious whether all of the improvement should be ascribed to its entry to the EU. In this context, it would be instructive to discuss briefly how Croatia fared with respect to corruption in the past too.
Last but not least, the analysis seems to assume that only Croatia will improve. Would Croatia experience equally large gains if other countries – most notably the other new member states but also the likes of Italy and Croatia – also experience improvements in their corruption levels?

(5) Croatia's EU entry will have little effect on the EU as a whole, given its small size. Therefore, the tiny gains envisaged for the current EU members are not surprising at all. Yet there may be important effects on the EU member countries in the same region, especially Italy, Greece, Hungary and Slovenia. Yet, these countries are merged with the rest of the EU countries into EU15 and NMS12. By doing so, some potentially interesting results may be missed. Similarly, countries such as Serbia and Bosnia are included in the rest of the world, although they will be affected by Croatia's EU entry much more than, say, Argentina. Given the topic of the paper, it would seem better to structure the model differently so that the effects on countries most likely to be affected can be measured directly.

(6) Finally, this is another in a sequence of similar studies by the same authors (more or less), using the same methodology and presumably coming up with similar findings. What is the original and novel contribution of this paper? We already know that trade liberalization translates into increased trade and that the small country benefits relatively more then the large free-trade block. If the main result of this paper is the impact of institutional improvement on trade and in turn on economic development and welfare, then perhaps the analysis should be refocused entirely. Instead of analyzing the experience of Croatia only and considering various effects of its EU entry, why not estimate and simulate the effects of institutional change in the wake of EU enlargements? Such analysis, however, should not only consider hypothetical gains in the future but should also measure the gains realized in the past. Did Greece, Spain and Portugal experience an improvement in the quality of their institutions that can be attributed to their EU accession? Did the 2004 cohort of new member states experience

any improvement? Were there improvements in institutions other than corruption? What lessons can we learn from past enlargements that are relevant for the recent and future enlargements?