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Financing the Enlargement of the European Union

The coming enlargement of the EU is unprecedented as regards both the number of acceding countries and the wealth differentials existing between the Union's current members and the candidates. The contributors to this forum present their views on how the complex financial issues involved can be solved in a way that will enable the enlarging Union to continue to function while ensuring a fair distribution of the costs and benefits of enlargement.

Barbara Lippert* and Wolfgang Bode**

Enlargement and the EU Budget: the Battles Ahead

Agenda 2000, the EU's reform package concluded in 1999, fixes the financial framework for an enlarging EU up to the year 2006. On this basis the EU is pursuing accession negotiations with the twelve candidate countries. Around € 45.4 billion was earmarked for six front-running candidates who it was thought would already be prepared to join in 2002. However, the earliest date for enlargement now seems to be 2004. Recently the Commission tabled its first ideas on how to distribute the € 40.1 billion (appropriation) among no less than 10 new members. First reactions to these still non-official proposals show that traditional cleavages between net payers and cohesion countries in the old EU-15 come to the forefront and give a foretaste of even more severe battles ahead.¹

In 2002 we can already see the first positions taken in view of what can be called "Agenda 2007". This new financial and reform package will have to tackle old problems and inconsistencies of distributive policies² in a completely new political environment of 25 or 27 members. Imminent questions to be addressed are: How can the Common Agricultural Policy (CAP) and structural policy work in an enlarging Union? What budget does the EU need to cope with the entry of relatively poor countries with proportionally large and unproductive agricultural sectors?³ These questions form the hidden agenda of the

current negotiations and shape the reform options which are under discussion.

From Agenda 2000 to Agenda 2007

In the future debate on Agenda 2007, it is likely that the current member states will maintain in principle the positions they took when preparing Agenda 2000. However, some member states may review their positions with regard to the budgetary effects of enlargement and the prospects of an ever-expanding EU budget. The current members have to re-consider whether they can stick to the status quo and their "budgetary share" or whether they take into account their new relative position in the wider EU.

In terms of decision-making processes the Commission deserves special attention. Given its monopoly over the initiation of legislation it plays a pivotal role in shaping policies and reforms. The Prodi Commission wants to strengthen market principles and liberalisation in the CAP while it is less reform-minded and less critical of structural policy. Here the current nominal ceiling of 0.45 % of EU-15 GDP (de facto the ceiling is only around 0.4 % in 2000 with a tendency to fall to around 0.3 % in 2006⁴) is seen as

¹ See European Commission: Communication from the Commission. Information: Common Financial Framework 2004-2006 for the Accession Negotiations, SEC(2002) 102 final, 30.1.2002, Brussels.

² See the critical review by Rolf Caesar, Hans-Eckart Scharrer (eds.): Die Zukunft Europas im Lichte der Agenda 2000, Baden-Baden 2000.

³ See the study by Christian Weise, Martin Banse, Wolfgang Bode, Barbara Lippert, Ferdinand Nölle, Stefan Tangermann: Reformbedarf bei den EU-Politiken im Zuge der Osterweiterung der EU, Studie für das Bundesministerium der Finanzen, Berlin/Göttingen, Mai 2001 to be published as "Die Finanzierung der Osterweiterung" in spring 2002 by Nomos Publications.

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the minimum that has to be earmarked for the EU-25/27.⁵ It is likely that the reform proposals that will be submitted by the Commission in early April will be along these lines.

CAP Reform and National Interests

In the CAP, reforms will probably follow the path set by the Agenda 2000: a further reduction of the guarantee prices and an added emphasis on rural development and perhaps modulation.⁶ Here, the upcoming negotiations in the framework of the WTO will work as an external challenge for reforms. However, the bones of contention are the direct income subsidies for farmers which today make up around two thirds of the total CAP budget. Although in the Agenda 2000 the 15 refused to extend these direct payments to the new members, the Commission now proposes to integrate them gradually into the subvention scheme until they have reached the 100 % level for the current members in 2013. Initially, direct payments will be linked to intensified structural aid for rural development and restructuring of the agrarian sector.

The controversial proposal to phase the new members gradually into the direct transfer scheme could work against efforts to decrease and phase out direct payments over the next decade. Originally, the 15 had denied farmers from the CEEC this entitlement because they were deemed not to be affected by the past reduction of the guarantee prices and, therefore, no compensatory payment seemed necessary. Moreover, extending direct payments to the accession countries might prevent those countries undertaking the necessary structural adjustments in their agricultural sector.

Thus, the gradual decrease of direct payments for the current members and – in the event of an extension to the new members the same in their cases – seems the key to reducing CAP spending.⁷ The candidate countries argue that withholding direct payments means a competitive disadvantage in economic terms and a second-class treatment in political terms. “Hardliners” among the member states such as Germany, the Netherlands and Sweden, who fight for more rigorous reforms and control of expenditure, are concerned about the path dependency that could be induced by giving in now for the period 2004/06. Furthermore, some, like Germany, the UK, the Netherlands, Sweden, Austria, Finland and Luxembourg, favour co-financing as an additional or alternative way to limit expenditure and give an incentive to reform the CAP. This option is strictly refused by France, Greece, Spain and

Belgium. However, France still holds an ambivalent position with a view to direct payments and has not taken sides so far. A clear stance will probably not be shown until after the parliamentary and presidential elections in Spring 2002.

Structural Policy Reform – the Complexity of Interests

As far as structural policy in the enlarged EU is concerned, the member states have not yet fixed their positions clearly. Moreover, the need to reform and not just to adapt and extend structural policy to the new members is not that imminent and evident to all member states. One reason might be that all member states, even the richer ones, benefit from structural policy. More than € 100 billion of the total of € 212 billion (available during the period 2000-2006) goes to countries that have a national GDP over 90 % of the EU average. Thus a complex web of interests surrounds structural policy that is difficult to break up.

However, the Commission and the status quo oriented member states, namely the cohesion countries, argue that the funding for the EU-15 members should not be reduced and that the new members are in need of structural aid to a large extent.⁸ Therefore, the European Commission and status quo oriented members still foresee a minimum of 0.45 % of the Union's GDP for structural policy. Compared to the expenditure in 2000 (€ 32,045 million) the budget for structural programmes will increase in relative and – because of a growing EU budget – absolute terms.

Contrary to this demand-led approach, the net payers in the EU argue for a concentration of funds on the poorest regions of the enlarged Union, i.e. the candidate countries, and the taking into account of the economic convergence processes in the Union by effective graduation from transfer schemes. Moreover, the absorption rate of 4 % of national GDP should be maintained for total transfers from the EU budget to

⁴ European Commission: Unity, solidarity, diversity for Europe, its people and its territory. Second report on economic and social cohesion, Brussels 2001, p. 121.

⁵ See Michel Barnier: Ansprache auf der Konferenz „Zehn Jahre europäische Strukturfonds in Ostdeutschland und deren Perspektiven im Hinblick auf die Erweiterung“, Magdeburg, 18 Oktober 2001.

⁶ The modulation mechanism in the CAP provides that, based on a decision on the national level, a part of the direct subsidies from the EU budget can be dedicated to rural development measures.

⁷ See for a more detailed analysis of the phasing out of the direct payments: Christian Weise et al., op. cit.

⁸ The Commission is of the opinion that after 2006 the total transfers to the new members can even exceed the fixed absorption rate of 4 % of the national GDP, see: European Commission: Unity, solidarity, diversity ..., op. cit.

the member states. This puts the brake on total transfers for the new member states in particular.

With the accession of 12 relatively poor member states, the average GDP per capita will decrease by 18 %.⁹ This decrease will heavily affect the Objective 1 regions, because many of them will – in statistical terms – cross the threshold of 75 % of average GDP per capita in the enlarged EU, although this decrease does not correspond with economic convergence in real terms. So the question arises whether the current thresholds – 75 % of GDP per capita for Objective 1 area eligibility and 90 % of GDP for the cohesion funds – should be maintained or raised, so that old beneficiaries can maintain their former Objective 1 status. The future eligibility of the current member states will mainly depend on this decision.¹⁰ In Germany for example only Dessau and Chemnitz will remain Objective 1 regions if the threshold for structural policy is not modified in an EU of 27. While more reform-oriented countries (e.g. the Netherlands, Belgium, Sweden, Austria, Denmark, Finland, Luxembourg) favour (degressive) transitional arrangements for the newly non-eligible members, status quo oriented members seek as much compensation and therefore adaptation of the threshold as possible.

The debate on the future of the structural policy is focused on the following options:

- regional or national indicators for eligibility;
- concentration of means on regions in need;
- simplifying the administration of structural policy.¹¹

With respect to the cohesion funds, initially introduced to support efforts to meet the Maastricht convergence criteria and join the Eurozone, it is expected that the beneficiaries – Greece, Spain and Portugal – but also the accession countries, will push for the prolongation of these funds. ISPA, the pre-accession funding system that finances infrastructure and large-scale projects in the candidate countries is already modelled on the cohesion funds.

Overall the Commission's proposals for a financial framework for enlargement for the years 2004-2006 under Agenda 2000 indicate that expenditure for structural policy (around € 25.5 billion) supersedes the CAP outlay (around € 9.5 billion) for the ten new members. The foreseen expenses for structural policy for the new member states are 2.3 times (2005) to 3.5 times (2004) higher than CAP expenditure. For the current EU, the ratio is the opposite: the CAP budget is 1.4 times as high as the structural budget. We can expect that structural policy will be the most dynamic expenditure category in the budget of an enlarged EU.

The own resources ceiling of 1.27 % of the EU's GDP is currently not fully exploited but will fall to 1.02 % in 2006. But in a Union of 25 or 27 members pressure will grow to fully exploit the 1.27 % ceiling or even raise this level. The opposition of the net payers to this expansion is clear.

The Decision-making Provisions of the Treaty of Nice

Given the complexity of interests in the old EU-15 and the uncertainties with regard to the (voting) behaviour of the new member states any decision on the new Agenda 2007 will be even harder to achieve than in Berlin in 1999 in an EU of 15. Several aspects have to be taken into account: normally the member states decide at the level of heads of state and government, and this means unanimously, on the financial framework and the policy and reform package. This is irrespective of the fact that in the CAP decisions are taken by a qualified majority (Article 37 EC Treaty). Only from 2007 onwards will qualified majority voting in the Council be introduced for structural policy. Moreover, the rules of the Treaty of Nice, once they have entered into force, make it even more difficult to reach a qualified majority. For this, a majority of weighted votes, of countries and population (quorum 62 %) is needed. When looking at possible policy-led or geographically defined voting coalitions one can easily see that neither net payers nor net beneficiaries, neither the "north" nor the "south", and neither new nor old members¹² constitute a clear qualified majority. Deadlocks abound and therefore any decision, based on consensus or qualified majority, requires a very broad consensus transcending the cleavages in the EU. Under these conditions, any fundamental reforms, and budgetary rigour, are difficult to achieve. Strategic partners for reforms must be the Commission (because of its monopoly to take the initiative) and those members that take a medium-term assessment of their interests and also look at their net payer position in an enlarged EU (e.g. France and Italy).¹³

⁹ Ibid.

¹⁰ The Spanish government already referred to that point in a memorandum, published in April 2001. The government asked to link the discussion on the future of structural policy and the accession negotiations.

¹¹ See European Commission: First progress report on economic and social cohesion, Brussels, January 2002.

¹² In the EU-25, the ten new member states will have no blocking majority whereas in the EU-27 the 12 new members do.

¹³ See Barbara Lippert, Wolfgang Bode: Die Erweiterung und das EU-Budget – Reformoptionen und ihre politische Durchsetzbarkeit, in: *Integration*, Vol. 4, 2001, pp. 369-389.

Timetables for Enlargement and Policy Reforms

While the roadmap for the conclusion of accession negotiations is fairly clear, the timetable for the new financial and reform package is not. The official line is that negotiations are carried through on the basis of the *acquis* of today and that the reform agenda has to be kept separate. However, with a view to the CAP, some member states (e.g. Germany, the Netherlands and Austria) speak of changing the *acquis* over the next few years, irrespective of the negotiation process. A minimum requirement would be to agree – still among the 15 – on the cornerstones of a CAP reform. An obvious opportunity to launch reforms is the mid-term review of the CAP that will be submitted by the Commission in June 2002.

As far as structural policy is concerned, the next cohesion report of the Commission due in 2003 can serve as a basis for a new debate. Nevertheless, it is most likely that the “real battle” will start after enlargement. Settling Agenda 2007 can be regarded as the first challenge for the enlarged Union. With the adoption of the financial framework for the years 2007 to 2013, the EU has to prove its ability to act effectively, to redefine solidarity for a larger and more diverse membership and to find a fair way to share burdens.

Compared to the southern enlargement of the Union in the 1980s, the EU will be less generous with respect to the accession of the 12 candidate countries. Therefore, the foreseen and available means must be used efficiently, effectively and transparently. Moreover, the financial framework 2007/2013 has to correspond to the new challenges with which the EU is confronted, namely in external relations (e.g. in the Common Foreign and Security Policy and the European Security and Defence Policy, the Mediterranean Policy, pre-accession aid for Turkey and the EU programmes for the western Balkans, Russia and the NIS) and in its ambitions “to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion”.¹⁴ The forthcoming Agenda 2007 and the reformed CAP and structural policy have to consider these requirements. The potential to save money in these two fields of policy is considerable, depending on the intensity of reform.¹⁵ Estimates are that in comparison to the status quo, a moderate reform will reduce expenditure by € 16 billion in 2007 and € 10 billion in 2013. With a resolute reform of the CAP and structural policy, the savings amount to € 11 billion in 2007 (0.81 % of EU GDP) and € 23 billion in 2013 (0.57 % of EU GDP), with respect to the status quo. But if the status quo prevails, the operational expenditure could increase by between € 45 billion and € 65 billion in 2013. These are points of reference for the upcoming battle over the budget for which the current and the future member states are just preparing themselves.

¹⁴ See European Council: Presidential conclusions, Lisbon European Council, 23 and 24 March 2000.

¹⁵ Cf. Christian Weise et al., *op. cit.*, on the reform scenarios and their financial implications.

Klaus Froberg* and Monika Hartmann**

Financing Enlargement: the Case of Agriculture and Rural Development

The eastern enlargement of the European Union is the fifth and the most difficult one. Never before have 13 countries taken part in enlargement at the

same time. In addition, all the previous rounds involved countries with economies which were much less different to those of the existing member states and which had had democratic systems for a longer time. In addition to Cyprus, Malta and Turkey, this round offers accession prospects to ten Central and Eastern European countries (CEECs). This paper, however, will deal with only 8 of these, i.e. Estonia, Czech Republic, Hungary, Latvia, Lithuania, Poland,

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Slovakia and Slovenia (CEEC-8); Bulgaria and Romania are excluded from our analysis as the EU Commission¹ assumes that these two countries will not be ready to join the Union in 2004.

Of the 31 chapters into which the accession negotiations are divided, agriculture is one of the more difficult ones. Problems with this sector arise in the CEEC-8 as well as in the EU. For the acceding countries agriculture is economically much more important than for the EU. This is one of the reasons why the former demand the same treatment for their farmers as those in the EU receive. The EU, on the other hand, faces difficulties concerning the financing of the enlargement. Some of the current members such as Germany are reluctant to increase their gross contribution to the EU budget. If this viewpoint prevails, part of the budgetary outlays currently scheduled for payments to existing members will have to be shifted to the candidate countries, changing the net payments of the former. In addition to the budget dilemma, difficulties are likely to arise with regard to the WTO conformity of the Common Agricultural Policy (CAP) after enlargement. Both of these problem areas could best be dealt with by adjusting the CAP. Whether there is sufficient political support for such an undertaking is another question. But even without enlargement, the distortions due to the CAP at sector and national level are so great that a reform would be favourable anyway.

Negotiations on agriculture started with the Czech Republic, Estonia, Hungary, Poland and Slovenia (the so-called Luxembourg group) in June 2000 and with Latvia, Lithuania and Slovakia (members of the so-called Helsinki group) in June 2001. With Bulgaria and Romania negotiations have not yet been opened. Both countries are also members of the Helsinki group. The sensitive areas in the negotiations on agriculture, i.e. direct payments, production quotas and other supply management instruments have so far not been addressed, or at least not intensively. This also holds for rural development. On January 30, 2002 the EU Commission² unveiled its proposal on how to handle these issues. This is going to stimulate the debate on what kind of agricultural policy to offer the candidate countries. The final position of the EU for the negotiations has still to be approved by the member states. However, the Commission has

claimed that there is little room for manoeuvre. According to the road map, which has been endorsed by the European Councils, negotiations on the agriculture chapter as well as on all the others are to be completed by the end of 2002. An important date will be the meeting of the European Council in Copenhagen at the end of this year. This timetable is designed to allow accession of the successful candidates by 2004.

Phasing-in Period

In its issue paper the Commission calls for a ten-year phasing-in period with regard to direct aids to farmers in the candidate countries. The payments are scheduled to begin at a level of just 25% of the full contribution in 2004, the assumed first year of accession, rising to 35% by 2006 and reaching their full amount for the first time in 2013. However, it is suggested that candidate countries should be able during the transition period to continue with their own direct payments provided that the total level of both national and EU support combined exceeds neither the level of payments prior to accession nor the level applicable under the same scheme in the existing member countries. In addition, candidate countries can opt for a simplified payment scheme. This allows them not to follow the strict EU surveillance regulations for a time span of at least 3 and at most 5 years, i.e. they do not have to apply the Integrated Administration and Control System (IACS) for CAP direct aids from the beginning of their membership. The simplified approach is optional for each new member. According to the proposal by the Commission, the total amount of all types of direct aids that any one of the candidate countries is eligible to pay its farmers will be divided by the total agricultural area utilised. This average aid per hectare of utilised agricultural area can be paid to each farmer according to farm size, independent of production. In other words, in countries choosing the simplified payment scheme these direct aids would be completely decoupled.

It is suggested that the eligible amount of each type of direct aid, of which there are almost thirty different ones, should be established according to the specifications provided in the EU Commission's issues paper. The main parameters are base area, reference yields, quotas for milk and reference numbers for beef animals slaughtered, suckling cows and ewes. In determining these figures the Commission used as the reference period the most recent years available in the statistics, which usually do not go further than 1999. This procedure leads to deviations from what

¹ EU Commission: Enlargement and agriculture: Successfully integrating the new Member States into the CAP, Issues paper, Brussels 2002.

² Ibid.

the candidates requested which, however, are relatively minor as far as base area and reference yields are concerned. The figures in the Commission's proposal are 5% lower for the base acreage and 17% lower for cereal yields than the figures requested by the eight candidates together. At the country level, the relative differences are much larger. The Baltic states, especially, tabled considerably higher requests for these two figures.

In its issue paper of January 30, 2002 the Commission also proposed reference levels for production quotas. With respect to determining the sugar quota the Commission differentiates between net importers and net exporters. For the former, it is suggested that the A quota be set equal to the average net production of the years 1995 to 1999 while the B quota is set to 10% of the A quota. For the latter, the A quota is fixed to that part of the net production of the same period which has been consumed domestically, with the B quota taking up net exports. In addition, total quotas are not allowed to exceed internal consumption plus the quantity that can be exported within the limits of the WTO commitments. In the dairy sector quotas are set according to production figures on milk delivered and for direct sales from 1997 to 1999. The levels proposed by the Commission are in many cases much lower than those requested by the candidate countries. The reason is that the Commission has chosen the late 1990s as the reference period, while the period which most of the CEEC-8 thought to be more adequate for fixing production limits was the late 1980s. Thus, for the CEEC-8 the aggregate quota proposed by the EU Commission is about 17% lower in the case of sugar and even 33% in the case of milk than their corresponding requests.

Reactions by the CEEC-8

Especially the position of the EU Commission with respect to direct aids has led to angry reactions from nearly all of the CEEC-8, who do not agree with the proposal of a ten-year transition period. Although direct payments were introduced initially to compensate farmers of the current EU member states for the income loss caused by the cuts in price support, they have lost a large part of their compensatory character 10 years after being implemented for the first time and have instead become direct aid payments. This also is recognised by the Commission. It therefore no longer argues that the CEECs can be exempted from those transfers because they will not suffer price cuts. Its new

proposal of a gradual phasing-in of these payments is defended by arguing that the new members need to adjust their farm structure and that full payment of direct aids would hamper this process.

The new members reject the proposal of only partly granting the area payments and livestock premiums to their farmers over the first nine years for two reasons. From a political point of view, the proposal will create "first and second class" EU members after accession and thus can easily impede public trust in the Union on the part of those residing in the CEEC-8. Also, the economics behind the argument are questioned. If these transfers are not fully paid, competition becomes distorted to the detriment of the accession countries. This is due to the fact that the transfers are not completely production-neutral in the existing member countries. They might even undermine equal treatment and thus violate Community law. There can be no doubt that direct aids are an additional source of revenue for farmers and, furthermore, are free of any risk, e.g. of market price fluctuations and/or weather conditions.

In addition to those arguments there is another one which puts the transfer efficiency of the direct payments into question. They are paid with the aim of supporting those who farm the land. However, whose land do farmers cultivate? The share of land leased varies among the current member countries and even more among the new ones. It is rather high in some of the latter, reaching more than 80%, for example, in the Czech and Slovak Republics. Also, in some of the current member states more than 60% of the area cultivated is leased, in some regions such as the New Bundesländer of Germany the portion even amounts to 90%. Since the larger part of these direct aids is paid to acreage it is to be viewed as a subsidy for this production factor. As a consequence, much of these transfers will finally be captured by the owners of the land.³ Thus, a group of people will be supported who often do not even reside in the countryside but in urban areas and who may spend their money there. Hence, this transfer is, and would be, also largely lost for rural development.

Besides the two basic arguments mentioned so far, direct aids as currently implemented in the EU distort the production structure, since for many commodities these transfers are not paid at all and for the other products unequal amounts are provided. Problems

³ The more inelastic the supply of land, the more of the payments can be expected to end up in the pockets of the owner of the land.

with such a payment scheme may also arise in the ongoing WTO negotiations. Especially the countries belonging to the Cairns group and also the USA argue in favour of including these payments into the aggregate measure of support (AMS). Even if after enlargement the EU were not to violate the ceiling imposed on this indicator it may be subject to future reductions and with it the support of all corresponding instruments.

Budgetary Effects

A number of attempts have been made in recent years to estimate the budgetary effects of an eastward enlargement of the EU. Only a few of them consider the transfer of the most recently implemented CAP, the Agenda 2000, to the candidate countries. This for example holds for the calculations carried out with the CEEC-ASIM partial equilibrium model (Central and Eastern European Countries Agricultural Simulation Model) that has been developed at IAMO. The outcome of these model simulations will be presented and compared with those of other studies.⁴

The following results compare for the year 2007 a scenario in which the CAP as reformed by Agenda 2000 is applied in the ten CEECs (accession scenario) with a so-called reference scenario. In the latter it is assumed that accession does not take place and the national agricultural policies of each of the candidate countries, as implemented in 1997, will be continued until 2007.

When interpreting the impact of EU enlargement, it has to be taken into account that the gap in agricultural prices between the EU-15 and the candidate countries, which was once significant, has now diminished or disappeared completely for most agricultural products. This adjustment will continue with the full implementation of Agenda 2000. Only for beef, sugar and dairy products can the candidate countries expect significant price increases upon accession. The current price gaps between the new members and the EU are, however, not only due to policy differences but also reflect deviations in quality. This holds especially for beef and milk. Quality differences are expected to narrow as standards in production improve in the candidate countries. Given these developments it can be assumed that the price-induced supply and demand reactions in the CEEC-8

will be rather limited. Thus, it is not surprising that, according to the model simulation, the rise in export refunds to be paid from the EU budget due to accession is rather small, namely € 0.6 billion at 1999 prices.

This result is also strongly influenced by the development of world market prices. For the simulations with the CEEC-ASIM model, these prices were taken from forecasts by other analyses dealing with changes in global supply and demand conditions. According to these forecasts EU producer prices for cereals will roughly equal those prevailing on the world market. Therefore, wheat exports in 2007 by the then enlarged EU do not require payments of export refunds - as is also the case currently. Though for other commodities world market prices are expected to remain below those prevailing in the EU the gap is substantially smaller than that observed at the moment. By far the largest portion of export subsidies will be necessary for milk and beef.

For the EU agricultural budget the full transfer of area payments and livestock premiums to the acceding countries would be expensive. As simulation results reveal, the burden placed on the EU budget for this type of support would increase by € 4.7 billion per annum.⁵ The largest part, amounting to almost 80%, would be required for area payments (cereals, oilseeds, protein crops and set-aside) while premiums paid for beef cattle and dairy cows would account for the remaining 20%. The full transfer of the Common Agricultural Policy to the CEEC-8 would thus increase the outlay for agriculture by € 5.3 billion at 1999 prices.

The results of similar studies conducted more recently vary to some extent. In their report commissioned by the German Ministry of Finance, Weise et al.⁶ calculate the budgetary consequences for transferring the first pillar of the CAP to the eight CEECs at € 8 billion in 2007 at 1999 prices. Based on results obtained with the European Simulation model (ESIM) these calculations also assume full payment of direct aids to candidate countries. As in the IAMO study, the largest share of the budgetary burden is due to direct aids, which account for € 6.0 billion or 74%. The remaining € 2.1 billion would be needed to cover

⁴ These calculations do not include outlays for olive oil, fruits, vegetables, wine, grapes and ewes. The budgetary outlays for administrative purposes are also not included.

⁶ C. Weise, M. Banse, W. Bode, B. Lippert, F. Nölle and S. Tangermann: Reformbedarf bei den EU-Politiken im Zuge der Osterweiterung der EU, Study for the German Ministry of Finance, Deutsches Institut für Wirtschaftsforschung, Berlin 2001.

⁴ K. Froberg and G. Weber: Auswirkungen der EU-Osterweiterung im Agrarbereich, Discussion Paper, Institute of Agricultural Development in Central and Eastern Europe, Halle 2001.

market support. These authors also estimate the burden for the EU budget of extending the second pillar of the CAP - outlays for rural development - to the CEEC-8 to reach € 2.1 billion per annum. The latter figure has not been included in the calculations undertaken by IAMO.

At the Agricultural Economics Research Institute (LEI), The Hague, an analysis was likewise conducted on the budgetary consequences of EU enlargement with the CEEC-8 in the year 2007. This study estimates the annual outlay to be € 7.5 billion, with € 5.3 billion required for direct aids and € 2.2 billion for market price support.⁷ The budgetary outlay necessary to transfer the second pillar of the CAP to the CEEC-8 is calculated by these authors to amount to € 2.4 billion.

Using the parameters of the proposal for direct payments forwarded by the EU Commission, *Agra Europe*⁸ estimates total direct aids for the CEEC-8 to be € 4.9 billion a year. This figure includes area payments to the *grandes cultures* as well as premiums for dairy, beef and sheep. The analysis by Silvis et al. also accounts for sheep premiums while the one by Weise et al. includes all types of payments including the budgetary outlays for administering the CAP in the future members.

Rise in Agricultural Expenditure

The results of the studies presented can be regarded as the range within which the future outlays from the EU budget for agriculture will fall after the CEEC-8 have joined the Union. The magnitude of costs for both market support and full payment of direct aids would imply a considerable rise in EU agricultural expenditures compared to the budget of about € 37 billion to be spent on agriculture (excluding funds for rural development) as estimated by the Commission and laid down in its financial perspectives. At the same time the CEEC-8 will have to make only relatively modest contributions to the financing of the EU budget as their share of the total GDP of the enlarged EU will be relatively small. In addition, transitional arrangements for the candidate countries are proposed in this respect as well in order to prevent a worsening of their net budgetary position at the time of enlargement compared to the year

⁷ H.J. Silvis, C.W.J. van Rijswijk and A.J. de Kleijn: EU agricultural expenditure for various accession scenarios, Report 6.01.04, Agricultural Economics Research Institute (LEI), The Hague 2001.

⁸ *Agra Europe*: Commission unveils blueprint for enlargement, in: *East Europe*, 2002, No. 233.

before. Thus, one of the reasons why the Commission has decided in favour of an extended phasing-in period with respect to transferring direct payments to the CEEC-8 might be in order not to exceed the expenditure ceiling agreed by the Berlin council. There is, however, no similar provision for the period after 2006.⁹

The analysis with respect to the budgetary burden of integrating the CEEC-8 into the CAP system was made assuming the EU is not forced to change its agricultural policies because of the enlargement. However, this hypothesis needs careful scrutiny. Reforming the CAP may be necessary in order to fulfil the WTO commitments made by the EU and the candidate countries. The three policy areas which are relevant in this respect – internal support, and here especially the AMS, market access and export subsidies – will be briefly discussed.

Recent studies by Frohberg et al.¹⁰ and Silvis et al.¹¹ come to the conclusion that even after enlargement the restrictions on the maximum possible outlays of all instruments belonging to the AMS will not pose a problem for the EU-23. The commitment would even make it possible for the enlarged EU to agree to a further tightening of this aggregate measure in the ongoing Doha round. However, a quite different perspective emerges if the expenditure for all direct aids had to be added to the AMS. They are currently included in the so-called blue box and therefore exempted from any reduction. Should they become part of the AMS the EU-23 is expected to exceed its limit of total outlays, implying that a change in the CAP would be necessary.

Another problem could arise with regard to bound tariffs. The EU-15 and the candidate countries have to find a common level for this protectionist instrument. WTO rules require that the bound tariff in the customs union cannot exceed the weighted average of the tariffs the countries had before integrating. With the exception of Poland and Slovenia the CEEC-8 have bound their tariffs at much lower rates than the EU-15.

⁹ W. Quaisser and J. Hall: *Toward Agenda 2007: Preparing the EU for East Enlargement*, Working Paper No. 240, Osteuropa-Institut, Munich 2002.

¹⁰ K. Frohberg, M. Hartmann, P. Weingarten and E. Winter: *Auswirkungen der EU-Osterweiterung auf die Beitrittsländer, Analyse unter Berücksichtigung der WTO-Verpflichtungen*, in: M. Brockmeier, S. von Cramon-Taubadel and F. Isermeyer: *Liberalisierung des Welthandels: Strategien und Konsequenzen*, in: *Schriften der Gesellschaft für Wirtschafts- und Sozialwissenschaften des Landbaues*, Band 37, Landwirtschaftsverlag Münster-Hiltrup (forthcoming).

¹¹ H.J. Silvis, C.W.J. van Rijswijk and A.J. de Kleijn, op. cit.

Thus, the EU will have to reduce its current import tariffs to the lower level of the accession countries. Alternatively, it could seek a mutual agreement with those WTO trading partners which stand to suffer from lost trade opportunities because the candidate countries increase their protection level to that of the EU-15.

The WTO commitments with regard to quantity and value restrictions on subsidised exports are likely to become the most binding of these three policy instruments following an EU enlargement. These limits already became binding for several products for the EU-15, thereby hampering exports. Commitments do not increase very much with the enlargement because the CEEC-8 have little to add to those of the EU-15. A first assessment of these policies indicates that especially the quantity restrictions on subsidised exports will become much tighter, and less those limiting the value. Vulnerable products are wheat, coarse grain, sugar, beef and milk, and thus partly those commodities for which the EU already has problems staying within its WTO limits.¹²

Application of Structural Policies

Not only agricultural policies belong to the *acquis communautaire*; structural policies are also part of it and, therefore, need to be extended to the new member countries after accession. As with agricultural policies, structural policies were designed in the Agenda 2000 without due consideration to the need of implementing them in the CEEC-8. The discussion above has shown that enlargement may affect farmers in the EU-15 if WTO commitments are violated and agricultural policies have therefore to be adjusted. Such an indirect effect also exists with regard to structural policies but it is much stronger. Extending the structural policies unchanged to the candidate countries would mean transferring a large share of the financial support currently received by existing member countries to the new ones after accession.¹³

This is due to the fact that many of the regions presently receiving support according to the objective one criteria, which amounts to about € 18 billion annually, would lose their eligibility: a region is declared an objective one area if its GDP per capita is lower than 75% of the EU average. When the struc-

tural policies are fully applied in the new members in 2007, they can expect approximately € 21 billion while only about € 5 billion would remain for the old members.¹⁴ However, the latter can receive some transitional payments for those regions which are no longer eligible for support according to objective one criteria. Nevertheless, it might be difficult for at least some old member countries to agree to an enlargement process if they stand to lose a substantial amount of financial support. Some of them which are currently net receivers will become net contributors to the EU budget in the future.¹⁵

In its issues paper the EU Commission proposes financing structural policies in the candidate countries up to 2006 in accordance with the cohesion fund of the Agenda 2000. It does not propose doing so to the limit of the absorption capacity - set by the EU at 4% of GDP per capita - and as granted in the existing EU-15. This also implies that at least for the years 2004 to 2006 the new members are not to be treated equally to the old ones. The Commission does not address the problem of what kind of structural policies to implement after 2006.

Conclusions

The proposal by the EU Commission can be seen as trying to achieve the impossible. The way the enlargement is to be handled should meet three major objectives. Firstly, the *acquis* is to be implemented such that there will be nothing resembling a two-tier agricultural and/or structural policy in the EU. Secondly, accession should not have any influence on the design of agricultural and/or structural policy in the current member states or prejudice future decisions on these EU policy areas. Thirdly, spending should be in accordance with the expenditure ceilings agreed by the Berlin European Council. The discussion has shown that the Commission's proposal is a rather weak compromise which only meets the last objective. As a consequence neither is the *acquis* implemented in the same manner in the new and the existing member countries nor did the EU seriously consider the financial burden of its proposal beyond the year 2006. This again might indeed set the stage for future adjustments of the CAP and structural policies for all member countries.

¹² S. Abele and K. Frohberg: The adjustment of EU structural policies in the course of eastern enlargement: A perspective, IAMO 2002, Institute of Agricultural Development in Central and Eastern Europe, Halle 2002.

¹³ Even without enlargement, some countries will switch because of the growth of their economy, which leads to the loss of eligibility for structural funds.

¹² K. Frohberg, M. Hartmann, P. Weingarten and E. Winter, *op. cit.*

¹³ W. Quaisser and J. Hall, *op. cit.*

A reform of both policy areas prior to enlargement would allow the EU to offer both the CEEC-8 and the current member states a sustainable perspective,

thereby easing the entire process of integrating the candidate countries and, above all, of improving efficiency in the Union of the twenty-three.

Friedrich Heinemann*

The EU Budget Must Get Rid of the Distribution Burden

The present debate on the fiscal consequences of enlargement suffers from a one-sided focus on numbers. The number which is currently cited most often is the budget ceiling of 1.27 per cent of EU GDP. From the debate, one could get the impression that every reform which allows the budget to remain below this ceiling after enlargement is a "good" one and that any development pushing the budget above this limit would stand for a failure of the Union's fiscal system. This is a distorted view since it is based on a too narrow definition of costs. For the following reasons, the level of EU spending as such is only an incomplete indicator for the assessment of this policy level's true economic costs and the full burden of enlargement.

First, substantial administrative costs resulting from EU policies are not included in the budget. The major burden in terms of the execution of EU regulations has to be borne by national administrations. A large number of national civil servants in the member countries spend their time with the administration of EU law. Furthermore, the never-ending reports on fraud in the context of Community spending and the regular attempts to cope with the problem through additional rules and institutions indicate high monitoring costs. Although a quantification is hardly possible, administrative and monitoring costs incorporated into the Brussels budget are probably only the minor part of these EU-caused cost categories.

Second, an important part of the costs resulting from EU regulation and spending programmes is of the non-fiscal type. The CAP is particularly cost-intensive since it burdens consumers with prices well above world market prices. With farming a whole sector is organised in a way bearing more resemblance to a centrally planned economy than a market economy. This system leads to high administrative costs within the sector's enterprises. Today, EU

farmers have to be at least as competent in EU law and the Community's administrative procedures as in their own business. In addition, the high level of protection in this sector brings significant losses in terms of static and dynamic efficiency to the European farm sector, but also to world markets for agricultural products.

Third, the heavy concentration of the EU budget on agricultural and structural spending policies is a big incentive for interest group activity. Thus, the EU spending priorities also result in high costs for rent-seeking. The fast growing number of lobbyists working in Brussels is evidence of this.

It is obvious that many of these types of costs will grow particularly fast with the accession of the Central and Eastern European countries. In comparison to the old member countries, these countries have large agricultural sectors in terms of employment and output shares. Furthermore, due to their low per capita income most of the regions of the new members will be eligible for structural funding. This not only increases the explicit costs reflected in the EU budget but also many of the above-listed types of costs falling outside of the EU budget.

The Distribution Priority is the Crux

Any concept targeted at the cost efficiency of European policies in an enlarged EU should therefore be based on a broad definition of costs including all the above-mentioned types. For the definition of any such concept the first necessary step is the identification of those characteristics of the system which are the cause of excessive cost.

The main problem with the EU budget in this regard is that up to now it has been dominated by distribution-oriented policies: 79.7 per cent (2002) of the budget is being spent either on the Common Agricultural Policy or the Structural Funds. The history of these spending policies and the recent reform debates

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indicate that a major driving force behind these expenditures is their inter-country distribution effect. A country like France has always been a fierce advocate of CAP spending and has so far blocked sensible reform options like the idea of co-financing raised at the Berlin summit in 1999. The obvious reason is that this country is a beneficiary of this policy field. Similar motives have caused the so-called Cohesion countries (Greece, Portugal, Spain and Ireland)¹ to battle for the expansion of structural funding.

From an economic perspective, there is not much to criticise about these distributive wishes. It is a political decision how much "solidarity" is to be practised between poorer and richer countries or between the relative winners and losers of integration. The problem for an efficient development of the EU budget, however, is that currently there is no cost-efficient distribution system. Instead, CAP and structural spending are abused for the realisation of inter-country distributive objectives. Distributive motives guide EU spending priorities and lead to massive inefficiencies in allocation. To illustrate this problem the Cohesion fund spending can be examined. One of this fund's spending priorities is the Trans-European networks. From the point of view of efficiency these resources should be distributed among EU countries according to the marginal benefits of network investments in each country. One would not expect this efficiency principle to favour poor and peripheral countries where marginal benefits from networks are probably lower than in wealthy and centrally situated countries. Thus, the distributive motive tends to produce inefficient allocations of budgetary resources.

The entire competencies of the EU level in defining regional policies in member states can also be regarded as one of these distribution-driven inefficiencies. Causes for regional problems differ widely and any regional development strategies must be tailored to these specific problems. Therefore, the national level is a more appropriate level for defining well-informed and promising regional development strategies than the EU level with its maximum distance from a region's problems.

The efficiency costs are even more visible for the CAP. The CAP is an anachronism in the general setting of the Internal Market, which is normally

guided by the principles of free trade and competitive markets. The reason for the successful defence of protectionism and a planned economy approach in the agricultural sector is the alliance between powerful interest groups and those member countries that benefit from the CAP's net payments. The discussions during the negotiations of Agenda 2000 demonstrated this coalition when the arguments of the German Bauernverband (Farmers' Association) were not too different from those of the French government.

Without a system change, the inefficiencies will increase with enlargement. The income discrepancies between new members from Central and Eastern Europe and the old member countries will emphasise the need to practice solidarity. If – as was the case in the past – new spending programmes are again tailored according to these distributive needs, new inefficiencies would be the outcome.

A Compensatory Fund instead of the CAP and Structural Spending

Having diagnosed the central obstacle for more efficiency in the EU budget the reform recommendations are fairly obvious. Any reform approach should aim at removing the distributive burden from the EU budget. The focus of the EU budget after enlargement should be on the financing of European public goods and not the channelling of funds between member countries.

Any realistic reform strategy should, however, not simply ignore the distributive objective. The challenge is to establish a new and more cost-efficient inter-country distributive instrument. If such an instrument existed, the EU budget could be redirected and concentrated on the provision of true European public goods. The existence of such a new distribution instrument would also dismantle many of the existing political and economic obstacles to reform: interest groups like farmers would lose their allies from member countries' governments since these governments' inter-country distributive wishes could be satisfied in a different way than through the extremely costly agricultural and structural spending.

A "compensatory fund" has been suggested which could serve as such a new instrument. This fund would have the function of realising the politically agreed extent of distribution.² The compensatory fund would have the following characteristics:

- The distribution between member countries would be realised through direct horizontal cash payments.

¹ In regard to Ireland the situation has, of course, changed fundamentally. Today, the country's per capita income (in purchasing power standards) is, within the EU, exceeded only by Luxembourg and Denmark (Eurostat, Statistics in focus, Theme 2 – 1/2002, Gross Domestic Product 2000).

- The member countries would agree on the direction and extent of flows unanimously.
- The EU institutions would have no role in administering the use of the payments.
- The donor countries would define general macroeconomic conditions for payments related, for example, to a recipient country's public debt or its level of public investment.

This fund would have many advantages compared to the existing CAP and structural funds based distribution scheme. It would be highly transparent. This transparency, together with the macroeconomic conditionality of transfers, would safeguard the prudent use of transfers in recipient countries in a much better way than is currently the case. Any waste would immediately reduce the willingness of donor countries to continue funding, which is a highly disciplining feature of the new system. Thus, the monitoring costs associated with today's intransparencies could be reduced. The normal rules of the Common Market (subsidy control, competition policy) would suffice to guarantee a use of funds in recipient countries which did not distort competition. The suggested unanimity principle is not very different to the status quo, since agreements on the financial perspective and the own resource system require unanimity as well. Note that the relative winners of integration have an incentive to compensate the relative losers as long as integration is a positive sum game.

Parallel to the establishment of the compensatory fund the CAP and the structural funds would be reduced and finally dismantled altogether. In the European Commission, thousands of civil servants would become available for other functions. If member countries wished they could continue to support farmers or poor regions in a way that is consistent with the rules of the common market; for example through direct income support financed out of the national budget.

The biggest advantage in terms of present and future enlargement processes would be the following: the inclusion of new member countries into the core policy fields of the EU would no longer be burdened with the budgetary problems resulting from the EU transfer policies. The distributive question (payments into or out of the compensatory fund) could be

negotiated separately from the allocative question (inclusion of new countries in the provision and financing of European public goods).

Reform Chances Improve

It is obvious that this far-reaching reform proposal has no chance of being fully taken up in the near future. Nevertheless, there are first trends that can be interpreted as following the recommended path: the idea of nationally co-financing the CAP as discussed at the Berlin summit in 1999 would be a promising first step. If the CAP were increasingly co-financed by national taxpayers this would limit the inter-country distribution through an important EU policy field. A further argument backing some optimism about reform chances is enlargement itself. Without major reforms the costs inside and outside of the European budget will increase massively. These increasing deadweight losses from the current distribution system will make the system increasingly unpopular. This holds true for both net payers and net recipients since the latter also have an interest to look for distributive schemes with smaller deadweight losses.

Furthermore, eastern enlargement will turn net payers of the present EU into net recipients. Thus, important and politically influential countries like France or Italy could start to rethink their reform resistance. These new forces for reform will fully develop in the long run when the transitory protection of EU-15 countries (e.g. through limiting direct CAP payments in the new members) has expired.

In the meantime, a clear recommendation must be given: as long as the EU budget is not freed of the burden of the distributive policies it must continue to be heavily restricted. This holds in particular in regard to the Union's lack of tax competence. As long as the EU budget is primarily an instrument for channelling money from one country to another, the present own resource system remains appropriate. It characterises this status quo that any budgetary expansion is conditional on the consent of all member countries. If the net payers lost this veto power and EU organs could decide on the levy of EU taxes by majority decisions, this would be a most dangerous development. An alliance of EU bureaucrats, members of the EP, favoured interest groups and net recipient countries would strive for a larger budget at the expense of European taxpayers. Thus, an EU tax should only seriously be considered if the CAP and structural funding in their present form have ceased to exist.

²Friedrich Heinemann: Der Kompensationsfonds: Eine neue Finanzverfassung für die EU der 21+, in: Wirtschaftsdienst, No. 5/1999, pp. 293-299.

Elżbieta Kawecka-Wyrzykowska*

Merits and Shortcomings of the Commission's Financial Framework for Eastward Enlargement

The Communication on the financial framework for eastward enlargement released by the European Commission on January 30 this year,¹ contains both proposals which are advantageous for Poland and ones which do not meet Poles' expectations and require further discussion.

Positive Elements

One positive fact is the document itself. So far we have had the Interinstitutional Agreement of 6 May 1999² based on the Berlin political agreement on the Agenda 2000. Since then the situation has changed (the number of applicant countries qualifying for enlargement has increased, the situation on agricultural markets has changed etc.) The Communication allows us to assess the financial issues of enlargement and creates a basis for discussion.

The more detailed positive aspects of the document are the following:

- Direct payments in favour of the farmers in the new Member States, not included in the Berlin framework, are now proposed.³
- The Commission has increased the EU co-financing share in projects for rural development in new Member States – to 80% – meaning that the new Members' co-financing rate will be 20% and not more.
- More money (1/3) has been devoted to the Cohesion Fund at the expense of the other structural activities (human resources development, productive investment etc., which will absorb the remaining 2/3 of the total funds foreseen for "structural policies"). The advantage of such proportions is that they reduce the amount of money needed by beneficiaries for co-complementing EU funds, as the co-financing rate of the Cohesion Fund is only 15% while for other structural funds it is 20%. Moreover, the management of bigger projects under the Cohesion Fund (in infrastructure and

environment) is easier, thus additionally improving the absorption ability of new Member States.

Dissatisfying Elements

For some categories of expenditure, mainly for structural measures which comprise the biggest portion of total financial transfers provided for new Members,⁴ the amount of support takes as its point of departure smaller amounts than those available under Agenda 2000 for 2004 to 2006. With such an approach to structural funds, the Commission has saved about € 4.5 bn (the difference between the original ceiling provided for in Agenda 2000 for the period 2004-2006 and the present ceiling presented by the Commission in January 2002). The main reason for this change, according to the Commission, is the limited absorption capacity in the first years of accession.

Certainly, establishing absorption capacity is a big challenge for the applicant countries. If absorption is not created in due time, the negotiations on more favourable financial terms will be fruitless. Every effort should be undertaken by the applicant countries to establish the institutional, legal and financial systems necessary to apply the EU funds quickly and efficiently.

In reducing the amounts for regional operations the Commission seems to have prejudged the low level of absorption capacity in the new Member States. It is, however, too early to take such a decision, as some time is still left for acquiring new skills. We should wait and examine the situation after accession. If absorption ability is still low and new Members do not

¹ Communication from the Commission: Information Note: Common Financial Framework 2004-2006 for the Accession Negotiations, Brussels, 30.1.2002.

² Interinstitutional Agreement of 6 May 1999 between the European Parliament, the Council and the Commission on budgetary discipline and improvement of the budgetary procedure (OJ C 172/99).

³ Let us note that the money for direct payments has been "found" in the box "structural policies". In other words, direct payments are not an additional offer but a result of the restructuring of the EU budget.

⁴ For example; the Financial Framework of January 2002 provides € 7067 million in 2004 for structural operations and € 3727 million for all other types of support.

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use all the money offered, the present EU Member States will be offered some savings. But if the absorption is higher, more money for new Members will serve to reduce the economic disparities faster and to speed up economic and social cohesion inside the enlarged Community.

So far, the EU has promoted the idea of cohesion to reap the maximum benefits of integration. Cohesion policy has been based on equity arguments (total welfare will increase if the inequalities between groups and regions are removed) and on efficiency arguments (regional and social policy helps towards a more efficient allocation of resources in a system where markets do not function perfectly).⁵ All EU members, including the richest countries, have benefited from this policy. Without cohesion policy instruments the development of European integration (especially monetary union) would have been delayed. At present, poorer countries face EU enlargement and expect benefits stemming from cohesion policy. If the EU reduces the cohesion and structural funds for the candidate countries – which seems to be the case in the light of the Commission's document – the integration process will become more difficult, thus affecting negatively both the new and the present Member States.

It is also dissatisfying that the same amount of money as provided originally in the Berlin agreement⁶ is to finance ten instead of six new Member States. This means lower transfers for each of the new Members. Also, in this way the eastward enlargement has become much cheaper for the present EU Members.

Partial Payments

Partial instead of full direct payments to new Members' farmers have been proposed, i.e. only 25% of the present EU system in the first year of accession. Moreover, the document provides for a very long period – 10 years – for the gradual increase of those payments up to 100% of the present EU system.⁷

The assessment of this proposal is probably different in individual candidate countries, taking into account their different patterns of agricultural production, number of farms, role of agriculture in GDP and employment etc. One common element is that without full payments candidate countries' farmers would not be treated equally to the EU

farmers. On many occasions the EU representatives have stressed that observing the rules of the internal market is a priority in negotiations. The Commission's proposal obviously distorts the rules of the internal market.

With partial payments new Members' farmers would be deprived for a long time of an important element of the incomes enjoyed by the EU farmers (estimated to amount to about 40% of the total incomes of EU farmers).

The Commission's argument is that full direct payments to the farmers in the "poor" new eastern European members would boost agricultural income in the CEECs more strongly than in other sectors of the economy and thus threaten to cause social conflicts. However, studies conducted in Poland⁸ do not confirm the thesis that direct payments would distort income parity at the cost of the non-agricultural population. The average level of farmers' incomes in Poland is at present much below the average for incomes in other sectors of the economy. So even if farmers' incomes increased by the full amount of direct payments, they would still be below the average incomes of the non-agricultural population. From this point of view there is no risk of any social unrest and dissatisfaction within that part of the Polish population which does not benefit from direct payments.

At the same time, without full payments – or other instruments guaranteeing equal financial conditions to the candidate countries from the very beginning of accession – the gap between the level of farmers' incomes in the present EU members and that in future EU Members would increase. More important is the fact that the differences in the competitive strength of present and new Members would also increase. In the EU, payments not only support incomes but also play the role of subsidies compensating for the higher costs of production of some farmers. Polish farmers, deprived of payments, would not only be poorer as compared to EU farmers, but also less competitive. The result would be increased imports, reduced domestic production etc.

⁷ In the next two years the initial figure of 25% will increase by 5 percentage points – up to 35% in 2006. In the second step after 2006, direct payments would increase further to reach the full amount in 2013 (10 years altogether). They would be organised in such a way as to ensure that the new Members reach "the support level then applicable". The second step has been described in a very careful way. Does the Commission not count that by that time the payments will disappear?

⁸ By the Institute of Agricultural Economics and Food Economy.

⁵ W. Molle: *The Economics of European Integration. Theory, Practice, Policy*. Dartmouth 1994, pp.421-426.

⁶ In fact it is even slightly less, see above.

The second argument usually presented by the Commission against full direct payments is that they would block structural changes in agriculture (as payments would encourage farmers to stay on the farms). Let me state emphatically: the solution to the problem of the structural backwardness of Polish agriculture lies outside the sector and is very loosely related to agricultural incomes. Structural changes in the agricultural sector will be speeded up by faster economic growth and new jobs outside agriculture. Farmers will be encouraged to leave their farms not because they are poor – without direct payments – but when they see prospects for work and reasonable incomes in other sectors of the economy. Without payments, some of them will stay poor, with no money for investing and restructuring their production. The risk of increased hidden unemployment in agriculture as a result of unequal competition is much more dangerous than the risk of too high agricultural incomes.

Also, the allegedly high costs of full direct payments are cited in the EU as an argument against this type of support for CEEC farmers. Certainly, equal treatment with full payments to present and new Members would cost more – probably four times the present proposal at the level of 25% of full payments, i.e. € 4.8 bn in the second year⁹ of accession of new members instead of the presently proposed € 1.2 bn. However, in financial terms this sum could probably be found within the present budget, e.g. in the money “saved” in the pre-accession funds after enlargement. Assuming that ten countries join the EU, only two countries will remain eligible for more than € 3 bn per year of the pre-accession funds which are presently used by all the candidate countries. Part of this sum could probably enlarge accession funds.

Certainly, equal treatment of farmers can be achieved in different ways: direct payments are one of a number of economic policy instruments. If – for a number of reasons – the EU wants to keep an adjustment period for the phasing-in of direct payments to farmers in eastern Europe (but not a 10-year period!), it should agree on other solutions to make competition fair in the agricultural sector. Otherwise, taking other EU proposals into account as well – including low production limits for basic agricultural products – there is a risk of a reduction in Polish production, to the benefit of imports from the EU. It is

hard to accept such a solution in view of the increasing demand for food products. Poland has a good potential for profitable production!

In light of the Commission's proposal, suggestions have been submitted to Polish negotiators to look for transitional solutions in order to ensure equal conditions of competition.¹⁰ They are not, however, the official position. The Government has been waiting for the common proposal of the EU-15.

Equally problematic to the low initial level of payments is the 10-year transitional period to the full level of payments. Reduced payments for such a long period cannot be accepted. As already stressed, they infringe the idea of the common market, so strongly stressed by the EU in official declarations, and thus the idea of fair competition in a common market. Moreover, it is not clear what the shape of the CAP in the coming years will be, taking into account the discussion on the reform of the CAP that has already started in the EU.¹¹ The whole idea of agricultural solutions going beyond the year 2006 is unacceptable for Poland. They mean that the country – although already in the EU – would be deprived of its influence on decisions in the future!

The Commission's proposal on direct payments also has other unfavourable implications that cannot be ignored in Poland. The refusal of full direct payments creates the impression of “second-class membership”. This proposal has already provoked increased dissatisfaction with accession negotiations and threatens to cause greater opposition to EU membership. Protests have been expressed especially by Polish farmers who constitute a large social group. Most of the population seems to show solidarity with the farmers. Such sentiments are enhanced by loud eurosceptics who form a significant bloc in Parliament and have already strongly attacked the financial package. A negative assessment of the outcome of negotiations – if no change in the EU position appears – may threaten the result of the referendum which the Polish Government had declared would take place after the completion of negotiations (as a way of ratification of the Accession Treaty). Is this really the result the EU would like to achieve? Does it want to deprive Poland of membership through Polish citizens opposing the “unacceptable result of the negotiations”?

¹⁰ The idea has appeared of requiring a transitional period for the elimination of border barriers.

¹¹ The Commission's position on the future of direct payments is very “careful” – see footnote 7.

⁹ According to the EU rules, the first direct payments will be transferred to new Members with one year's delay (in the form of reimbursement for Member States' expenditure on direct aid).

Contribution to the EU Budget

While full payments are an important part of the negotiations, they should not overshadow the other elements of comprehensive accession negotiations. Direct payments are only part of the total agricultural package and, even more, they are only one element of the comprehensive financial package including many further instruments, which are important for the overall assessment of the negotiations.

However, the total financial proposal for the new Member States does not look promising either. Very disappointing is the Commission's expectation that new Members will contribute fully to the common budget from the first year of accession (will pay the full budgetary "fee").¹² Such an approach has only been used during the recent enlargement when the EU was enlarged by three rich countries. In every previous enlargement of the Community the new Member States have always benefited from transitional measures with respect to their financial obligations towards the Community budget.¹³ Why should the poorer new Members from central and eastern Europe be treated equally to rich EU members and deprived of the adjustment mechanism offered to poorer Members in previous enlargements?

At the same time, the Commission has declared that "no new Member State should find itself in a net budgetary position which is worse than the year before enlargement". However, it does not seem possible to achieve this by complying with the request for full contributions to the common budget. A number of reasons make this request very unfavourable for new Members: reimbursements from the EU budget for Member States' expenditure on direct payments in a given year are made from the EU budget of the following year, i.e. with one year's delay; first reimbursements for structural operations are made only after many months, i.e. after the acceptance and control of the successive parts of

programmes (first, programmes have to be worked out, then co-financed from national sources, implemented, accepted etc. and only afterwards can they qualify for reimbursement); payments to the budget on VAT and customs duties resources have to be made on a monthly or bi-monthly basis etc. The whole amount of money available in the first year of accession will come only 2-3 years later (for this reason the Commission distinguishes between "commitment appropriations" and "payment appropriations"). The lump sum of € 800 million for all new Members will not be sufficient to compensate the budgetary gap. The adoption of "full contributions to the common budget from the first year of accession" may result in new Members becoming net payers instead of net beneficiaries (or with a very low surplus). This would mean that poorer new Members are creditors of the present EU Members and they finance their membership in the European Union from their own money!¹⁴ Is this the solution the Commission wants to achieve?

Conclusions

The discussion on money is difficult in all countries and for all societies. However, the money foreseen in the Commission's Communication for "up to ten new Member States that are ready for EU membership" is equivalent to around 0.09% of the joint GDP of the EU-15! This is less than one tenth of one per cent of the EU incomes. Are stability and economic welfare in Europe not worth more?¹⁵

The very unfair aspect of the financial proposal is that the Commission wants the new Members to meet all the obligations of EU membership while depriving them of the full financial benefits resulting from the rules of the common budget. For this reason the document does not offer equal conditions to the candidate countries and present Members.

Fortunately, the document discussed is not the final version of the EU position. It is just a proposal by the Commission which, let us hope, will be changed by the Member States and will become more balanced, thus creating a good basis for negotiations.

¹² All candidate countries have requested treatment no less favourable in this regard than in previous enlargements before 1995. Poland has requested a 5-year transitional period.

¹³ "In 1981, Greece was granted a 5-year diminishing reduction (70% to 10%) in its payments on the VAT resource. In 1986, Spain and Portugal obtained a 6-year diminishing reduction (87% to 5%) of their payments on the VAT resource, extended to the GNP resource when it was introduced in 1988. In 1995, Austria, Finland and Sweden were granted 4-year lump sum payments out of the general budget decreasing from € 1.5 billion in 1995 to € 0.7 billion in 1996, € 0.2 billion in 1997 and € 0.1 billion in 1998" (cited from the Information Note. Common Financial Framework 2004-2006 for the accession negotiations). Also, in 1973, the UK, Ireland and Denmark obtained a 5-year diminishing reduction on their payments relating to traditional own resources and to VAT.

¹⁴ One example may be Poland's situation. According to very rough estimates Poland's share in the EU transfers for 10 new members will be about 50%, i.e. € 2840 millions in 2004 (in terms of payment appropriations), at the maximum. If the absorption capacity is not sufficient – which is very probable in the first year – in reality this amount will be lower. At the same time, Poland's contribution to the EU budget has been estimated at € 2.5 bn in 2004.

¹⁵ As already mentioned, possibilities for financial manoeuvre (without any additional increase of the financial burdens of the present EU Members) seem to be in the "box" of pre-accession funds.