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## Eastern enlargement of the European Union: Grasping it as a chance for reform

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# Eastern enlargement of the European Union

Grasping it as a chance for reform

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Eastern enlargement  
of the European Union  
Grasping it as a chance for reform

With a preface by Gert Dahlmanns

The original study, including a chapter of the transformation process in several East-European countries, was completed in June 1998 and published in Germany as no. 33 of the Kronberger Kreis series of the Frankfurter Institut.

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## Europe – our historic opportunity

### Gert Dahlmanns

No-one can relieve us in Europe of the responsibility described in this study. On the threshold of the next century, we Europeans – from the North Cape to the Mediterranean, from the coast of Ireland to the far reaches of Poland – carry a responsibility in politics, commerce and society: we are shaping the world for our children and grandchildren, and face two key tasks. We must prepare our respective countries and their citizens for the coming changes and at the same time find a viable structure for the future of our small corner of the world. The aim of all the efforts in this direction must be to ensure that the next generations can still live in peace and freedom and that they can develop their lives according to their own ideas. It is our duty – and one of our finest tasks – to work towards this and to take advantage of the current favourable situation.

We cannot be certain of success. As a result of our efforts, times are changing before our very eyes, and this will create in many respects a New World, a world which no longer follows the familiar patterns and which cannot be mastered using the traditional rules alone – neither globally nor within individual countries and societies.

Perhaps it will only be possible to grasp the real dimensions of the task of preparing our countries and our corner of the globe for this New World later, when we can take a more distanced view. Perhaps only the passage of time will show whether, in this historic situation which gives us a large degree of freedom to shape the future throughout Europe, we have made proper use of our chance or whether we have failed.

One of the major tests currently confronting us is the enlargement of the European Union to include central and eastern Europe. It is of far more than just economic significance. What it aims at, and what it makes possible, is no less than the institutionally-led return of nations and peoples – which have belonged to the core of Europe for centuries – to that very Community which has formed and structured itself in recent decades from west, south and north.

The accession of the countries to the east would complete the vision

of European unification which led to the founding of the European Coal and Steel Community back in 1951. This process, which was initiated as a peace-keeping instrument following two destructive world wars, was intended to enable common interests to be asserted in common institutions. Ever closer economic and political integration on the basis of a growing stock of shared interests was to bring Europe together as a functioning part of our world. The extension of the process to encompass central and eastern Europe is one of the most fascinating projects of the present day; it can rejuvenate the face of Europe and fundamentally enrich the life of its inhabitants.

### From the vision to the reality of the united Europe

However, visions do not become reality by themselves – and certainly not in day-to-day politics. It has always been true that more visions are dashed against the hard realities than are actually realised. Achieving them requires tenacious and painstaking work on all sides and in all areas – and repeated efforts to arrive at compromises. But this necessitates mutual comprehension and a concomitant ability to reach understandings. The difficulties that this entails have led to dangers and set-backs for the process of European unification often enough in the past. The sceptics believe that this very problem – of striking a balance between interests – will become virtually insoluble if the Union is enlarged to embrace twenty or more heterogeneous countries.

And so it will become all the more important, as the central and eastern European states come closer to the Union, never to lose sight of the prospect of a Europe which belongs together – a prospect which has only existed again since 1989. We should allow the forces which excited and encouraged us all when the Iron Curtain fell to guide and motivate us today – especially in view of the battles to hold on to privileges and the inevitable tedious work on the details, from the screening to the actual negotiations and the envisaged accession.

On the way there, all sides will have a lot of work to do. Firstly, the acceding states need to continue their reforms. Over the last few years, they have made the shift from socialism and central planning to the market economy – starting from different situations and at different speeds – and have thus, largely by their own efforts, achieved

a comprehensive change in the system that was unimaginable a decade ago.

Fundamental reforms in the fields of property, privatisation and the monetary system, with monetary reforms, the liberalisation of prices and foreign trade, and the establishment of a new banking and financial system have created the key conditions for companies in these countries to orient their work along market lines and to adapt themselves accordingly. Much detailed work remains to be done, but that is not the subject of this study. The fact is that, in view of its present state, the Union itself still has to undertake substantial reforms so that it will be equipped to cope with the new members and the whole venture can be a success: for Europe and its countries, for us today and for the next generations with whose interests we are entrusted.

### **The time of self-examination**

The question of whether and how to expand to the east is thus compelling the Union and its member states to reflect on themselves. It is forcing them to think harder about where the Community has come from and – particularly – where it is going. That has to be a good thing. So far, there have hardly been any coherent concepts at Community level for the future development of the European Union. There have been central considerations and generally shared justifications – from an overriding duty to preserve the peace to economic efficiency in the internal market with its wealth-enhancing effects – and, naturally, there have been different, generally complementary, reasons for the individual states to be part of the Union. All of this has mostly fitted together somehow or other, even if the costs have often been very high. So the road was marked out as it was travelled.

However, the coming enlargement of the Union towards central and eastern Europe is of a different dimension and quality again. It is now a matter of integrating countries and peoples who, for half a century, were forcibly subjected to a totally different economic and social system, to a system which was diametrically opposed to that of the existing member states. Faced with this task and opportunity, the Union cannot avoid a thorough review of itself, its

past development and its objectives.

In the past decades, in which the development of western prosperity has been almost unquestioned, too little effort has been devoted to this reflection – and to thinking and acting in ordo-liberal terms in general. The greater the rise in prosperity, the weaker the economic arguments became. Both in the individual member states and at Community level, internal attitudes and external institutions were formed which had less and less to do with the original idea of a market system based on competition and individual responsibility coupled with a supplementary system of reliable social security. In some countries, the concept and practical implementation of the social market economy deteriorated into a welfare economy characterised by an excessive level of government activity with certain market-based elements. Germany in particular often set an unfortunate example in this area. The consequences are apparent today. They include high unemployment and a threat to social security systems despite excessive burdens of taxes and welfare contributions and a mountain of debt which deprives the government of scope for policy-making and the citizen of room for manoeuvre.

This development can be seen in many member states and is also reflected – both overall and in many details – at Union level. Once again, the approach has tended to be “pragmatic” rather than ordo-liberal, less and less attention has been paid to subsidiarity, and emerging conflicts have been hidden by transferring money. The resulting structures which have developed and solidified are now creating problems for us. A Europe which is developing into a giant wealth-distribution machine with the corresponding bureaucracy, a Europe onto which the member states attempt to offload their unpleasant economic and social challenges so that they do not have to answer for them themselves – such a Europe will lose vitality and weaken itself in the face of the totally different conditions of the 21st century.

The necessary self-reflection has also begun in those countries of central and eastern Europe which wish to join the Union. They are very openly wondering what they and their citizens can expect from membership of the European Union and what they can contribute themselves. In discussions with open-minded observers of current events in those countries, it becomes apparent that – to put it simply

– the existing Union must not be allowed to view the countries in the east only as takers, with those countries merely expecting a shift in the prosperity frontier to the east. Institutional changes will not achieve much if we are not able to overcome this narrow thinking, to give life to all the cultural riches of Europe in this new Community, and to spark off enthusiasm in the younger generation, both here and there. If we fail to do this, the European Union will become larger, but it will wilt – not due to external forces, but from within.

### **An ordo-liberal concept**

This implies that, if the European experiment is to succeed, the decisive factor is the economic concept guiding it. The alternatives can already be seen from past experience in the Community. Either Europe becomes a structure based on an administered economy with uniform rules, regulations and standards, or it develops into a Europe of competition in which the mature citizen has a key influence on how he acts on the market.

Anyone familiar with the losses in efficiency and democracy caused by bureaucratically-directed economies can only advocate a competition-based system. Here, competition should be understood in a very broad sense: as the condition for the existence of and as a driving force for a free society and as a precondition for wealth-enhancing advances in productivity. One of the major tasks facing Europe's political and social forces is to open the gates to such competition and to keep them open.

However, priority for competition works in two directions: it necessitates a thinning-out of the jungle of superfluous regulations and interventions in the various member states and – at Union level – it must take precedence over regulated harmonisation. No matter how great the temptation for European bureaucracies to prescribe equal standards and directives for as many areas as possible, the overarching principle has to be this: as much leeway as possible, as little decreed harmonisation as necessary. The burden of proof should be borne by those who believe that harmonisation is needed, not the other way round.

Since the Middle Ages, Europe has been the subject of reflection and

political battles, the plaything of centrifugal and centripetal forces, the synonym for mutual destruction and attempts to rebuild. Now it is in the process of finding a new form and new content. It is a long journey and is preceded by economic integration. But it does not end there.

The monumental task is: whilst retaining European diversity, to create a space in which the citizens understand one another and combine their various forces and gifts – to improve the living standards for all people in this sphere, to expand their intellectual horizons and their sense of living, and to cope better with the global challenges which will confront this and future generations, particularly the preservation of a life-enabling environment.

The best way to achieve these goals is to orient the economic and social system to the concept of competition. Competition – rather than uniformity – also corresponds to the traditional way the European democracies see themselves and is a sign of healthy self-confidence.

### **What to do now**

This means that the coming integration and negotiations must create the conditions for a thriving Europe in the 21st century. The European vision must be retained as a driving force and, at the same time, we must be preserved from unrealistic illusions. We must avoid deception and self-deception now – to ensure that the future does not bring disappointments and set-backs.

This is the spirit in which the Kronberger Kreis – the Research Council of the Frankfurter Institut, consisting of highly regarded economists – wrote this study, now available in English. In an age in which work at the drawing board of the future is proceeding at a more hectic pace than usual, it aims to stimulate reflection and forward-thinking – about the state of the Union as a whole and the unavoidable need for reform in detail. This ranges from the mental reorientation of agricultural, structural and fiscal policy to substantial streamlining in the European institutions. The proposals made for this, to limit activities and expenditure, are at once fundamental and highly specific. Many of them reach beyond the most recent ideas of the Commission, as set out in Agenda 2000, and by way of

justification and illustration indicate the anticipated consequences if the Union should prove unable to rouse itself to undertake a genuinely fundamental renewal.

The study can therefore be read as an urgent appeal not to miss this historic opportunity of eastern enlargement, and instead to set the necessary process in motion in such a way that it is well thought-out, unimpeachable in ordo-liberal terms, and accompanied by the appropriate reforms, so that likely future conflicts do not arise but are resolved from the outset.

The first edition of the study was the focus of great attention in Germany and the centres of the European Union. It is now being made available to all parliamentarians and other selected leaders in the fields of politics, commerce and society throughout Europe, in order to stimulate the debate about the direction and shape of all aspects of the future Europe.

An enlargement of the Union based on these proposals could result in a Europe which, despite its geographical size, retains all its lively diversity because it is oriented to the principle of subsidiarity. It could become a Europe which conserves its resources and those of its citizens because it pays attention to efficient government activity. And it could come closer to the oft-quoted social justice because it allows scope for different ideas and approaches and does not rely only on the enforcement of rules in this area.

Above all, however, this could result in a Europe which is once again oriented to the central idea on which it was founded but which has suffered so greatly – the idea of the freedom and dignity of the individual.

Today, on the threshold of the next century, we have the historic opportunity for a lasting new construction of a Europe in freedom, an opportunity denied to the continent after 1945. Tomorrow, Europe will have become what we, the Europeans, make of it today. We need to prove worthy of this responsibility.



## Eastern Enlargement of the European Union

### Grasping it as a chance for reform Introductory remarks

The enlargement of the European Union to the east cannot be compared in any way with the earlier enlargements of the Community to the north and south. It is a question of the last step in the return to Europe of the central and eastern European countries which were cut off for almost half a century. It is a question of the integration of just over one hundred million people whose economic output is currently no more than a fraction of that of their western European partners. It is a question of the membership of countries whose agricultural potential is so great that the old Community will not be able to continue with its existing agricultural policy – the policy on which it has spent most money by far over the last forty years. It is a question of increasing the number of members to a level which will no longer fit into the framework for which the six states party to the Treaties of Rome designed and created the Community institutions in 1957.

At the same time, this great and almost offputtingly difficult project is a fascinating one. By realising the project, Europe would show that – as with the founding of the Community, as with the creation of the single European market and European Monetary Union – it still has the strength to voluntarily take on a challenge and undergo a change which will put a question mark over an unprecedented number of privileges and entitlements and break up old, even rigid structures, thereby gaining its own future, and that it is still far from renouncing its role in world history by consuming the capital it has accumulated in the past.

If the enlargement project is to be realised, it will be insufficient to get the citizens of the present European Community to calculate their own personal advantages from it, because the preservation of privileges and the comparison of anticipated short-term costs and benefits play a major role in such calculations, and so such calculations do not work out. The project needs a vision of how much willingness to change is required to ensure the survival of the European way of life. However, this study does not focus on the

visionary aspect of the project, which is a matter for the politicians – and is by no means related solely to the eastern enlargement of the European Union. Instead, it looks at the rather more sober aspect, which is to demonstrate that the problems awaiting us, though extreme, are not insoluble. With its Agenda 2000, the European Commission has already gone in this direction; many people find this terrifyingly courageous, yet it is not courageous enough.

The Kronberger Kreis would like to thank Jürgen Stehn of the Institute for World Economics, Kiel, for his important and detailed work on this study.

## I. Current situation

1. In line with the decisions taken by the heads of state and government of the European Union at the Luxembourg Summit of 12-13 December 1997, the EU entered into specific negotiations on accession with six countries at the end of March 1998. They are five central and eastern European countries, i.e. the Czech Republic, Estonia, Hungary, Poland and Slovenia, and Cyprus. At the same time, accession procedures as defined in Article 49 of the new version of the EU Treaty (formerly Article O) have officially commenced with five further candidates: Bulgaria, Latvia, Lithuania, Romania and Slovakia. Thus, the starting line model (the simultaneous beginning of specific negotiations with all eleven candidates), as particularly called for by the European Parliament, was not chosen, nor was the group model favoured by the Commission, whereby negotiations should be held solely with the first group of six states. Instead, the approach taken was a compromise: specific talks on accession are restricted to the group of the first six, but, if appropriate, those in the second group may be able to transfer to the first group as negotiations progress, and even overtake them when it comes to the timing of accession.

Turkey's request to accede was not taken up. However, the country was invited to take part in a Europe Conference; these conferences are intended to provide a platform for an exchange of views of all those countries who in principle come into question for membership of the European Union. The Turkish government rejected this offer as inadequate.

2. In addition to the eleven candidates for accession, there are further European countries which may also like to join the European Union in the longer term. These are the three west European countries whose citizens have in the past rejected closer alignment with the Union: Norway, Switzerland and Iceland. The Mediterranean island of Malta had already submitted a formal application for accession, but withdrew it again after a change of government at the end of 1996. And then there are the Balkan states of Albania, Bosnia-Herzegovina, Croatia, Macedonia and Serbia with Montenegro.

3. The legal framework for new membership is provided by Article

### **The Luxembourg Summit of December 1997**

### **The criteria**

49 of the EU Treaty. According to this, an application must be addressed to the Council. After consulting the Commission and receiving the assent of the European Parliament (by an absolute majority of its members), the Council shall reach a unanimous decision. The conditions for accession and the necessary amendments to the European treaties are then arranged in an agreement between the member states and the country wishing to join. This agreement must be ratified by all the contracting states in accordance with their constitutional rules.

4. In its decision, the European Council was guided by criteria which it first formulated at the meeting of heads of state and government in Copenhagen on 21 and 22 June 1993. They determined the way the candidates have been divided into groups.

*“Membership requires that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces with the Union. Membership presupposes the candidate's ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union.*

*The Union's capacity to absorb new members, while maintaining the momentum of European integration, is also an important consideration in the general interest of both the Union and the candidate countries.”*

This means that the option of full membership for central and eastern European countries has met with political acceptance. It would seem that other concepts for integration – eastward enlargement of the European Economic Area, the establishment of a free-trade zone between the European Union and those wishing to join, the so-called EFTA solution, and the mere linking of central and eastern European countries via association agreements – have been overtaken by developments.

5. The scale of the coming enlargement of the European Union to

include six/eleven additional countries is scarcely comparable with past enlargements – Denmark, Britain and Ireland in 1973, Greece in 1981, Spain and Portugal in 1986, Finland, Austria and Sweden in 1995. It is a secular process, both for the candidates and for the Union. With regard to the central and eastern European countries, people have aptly spoken of their “return to Europe”. And, at the end of the process, the nature of the current Community of Fifteen will have changed, whether the Community wants it to or not.

6. Apart from Greece, which is a rather unfortunate exception, the question of whether newly acceding countries are ready for membership has not arisen. In the case of the central and eastern European countries, which were more or less ruined by forty years of communist rule, this is a vital precondition. The Copenhagen criteria rightly stress this point. The six countries with which there are to be specific negotiations on accession will boost the population of the Union by 17 %. At the same time, the Union’s gross national product will grow by only 3 %. Taking all eleven candidates together, the corresponding figures are 25 % and 5 %. With the exception of Cyprus, all the candidates for accession will, under the current rules, be net recipients of Community funding. For the candidate countries, the question arises as to whether they can actually cope with the Community’s rules yet. And on the other side, the Community of Fifteen may easily be overburdened if it takes on the new members without appropriate adjustment measures. This is particularly true of the high-expenditure agricultural policy – which currently accounts for about half of the EU budget – and for the various forms of structural policy.

7. In these circumstances, even the fundamental freedoms of the European Union become a problem. This is particularly true of freedom of movement for workers. In the existing Community of Fifteen, there have so far been no substantial migratory flows. Unlike in the United States, for example, the mobility of people in the European Union is restricted due to linguistic and cultural ties to the home region. In addition, the overall economic development in the various member states has resulted neither in a demand pull for foreign workers nor in pressure to emigrate. It may well be that the people in central and eastern European countries are very willing to move around. The prosperity gap is enormous, and many may hope to find better income prospects in the highly developed

## **Objectives and conflicts**

countries of the Community than at home. The experience gained in the relationship between Germany and Poland at the turn of the century may provide an indication of what we have to expect. In addition, the Treaty of Amsterdam has made the Schengen cooperation part of the *acquis communautaire*. If they become members, the central and eastern European countries will have to guarantee the protection of the EU’s external borders. The problems that can arise here are clear from the example of Italy, a founding member of the Community. Until recently, it gave economic migrants a period of fourteen days in which to leave the country. Critics claimed that the migrants were basically waved through to other EU member states, and primarily to Germany. Both aspects – the freedom of movement for workers and the security of the EU’s external borders – will be vital factors in the acceptance of the eastward enlargement by the existing member states.

8. The institutions of the European Union were tailored to the original Community of Six. The structure was determined less by the desire for full democratic legitimacy from the bottom to the top, as is the pattern in traditional nation states. Instead, the Community’s institutional set-up primarily aims to strike a balance between Community interests and national interests – this is the basis for the special role played by the European Commission – and to ensure a balance of interests between the larger and smaller member states – served by a system of weighted voting which is as complex as it is graduated. By taking on eleven candidates, the Community of Fifteen would become a Community of twenty-six member states. The population would increase to nearly half a billion. This would pose a challenge for the ability of the institutions and the European Union to function. Those wishing to “deepen” the Union, e.g. by creating genuine competence for foreign and security policy, will see a conflict between that sort of deepening and enlargement. This leads to the question of what the process of European integration should and can aim for. Will the eastern enlargement not inevitably stabilise a Europe of the governments, in line with British and French ideas? In view of the aim to deepen the Community, is it not at least one step into utter uncertainty?

9. Careful thought needs to be given to the impact of the eastern enlargement on the cohesion of the nations, on the possibility of cross-border internal closeness between people and of a sense of

solidarity which is needed for majority decisions to be tolerated by minorities. There can be no talk of any of this at present, even in the Community of Fifteen. Just one aspect of this is the lack of even the slightest indication of a European public opinion which follows and monitors political decisions and brings them as close to "truth" as possible (J. St. Mill). So far, the European treaties have largely, and perhaps unavoidably, excluded the cultural and mental dimensions of the process of integration. If the Union expands by up to eleven additional member states, any attempts to gradually tackle this deficiency would presumably be rendered rather more difficult. There is a widespread complaint about the inadequate democratic legitimacy of the rulers who have created economic integration driven by (justified) promises of greater efficiency and set up the institutions primarily designed to serve this end. However, the acceptance of more democracy implies preconditions which cannot be created by rules and regulations.

The question of language is a particularly striking aspect. In the Community of Fifteen, eleven different languages are spoken; in the Community of Twenty-six, there would be twenty-two.

Ernest Renan once said of Europe that it was "born of the Greek miracle, grew up with the Graeco-Latin culture, experienced a Renaissance and is Christian". Today, we would probably add that Europe carries the legacy of the Enlightenment, from which both the free order and the European welfare state derive. If the Union were to expand and extend beyond Europe, it would have to depart from these historical and cultural foundations, or at least alter them.

10. There is no coherent concept for the further development of the European Union at Community level. The attempts at the Intergovernmental Conference of Amsterdam to achieve institutional adjustments in the Union prior to the process of enlargement basically failed. At the end of 1999, there will also be a review of the system of Community finances, i.e. a further development of the Council of Ministers' decision on the system of the Community's own finances. In this context, the Federal Republic of Germany is endeavouring to downsize the substantial role it plays as a net contributor. In addition, there are the challenges relating to the completion of European Monetary Union. Against this background, it may surprise one that the European Council and the political

### Constant interests

forces represented on it were able to reach any agreement at all at the Luxembourg Summit on specific negotiations on accession for countries to the east. There are many reasons why it was possible: some involve more than one country, some are specific to a certain country, and political considerations play a major role alongside economic aspects. At a fundamental level, there is a certainty that this is a logical step in terms of the process of European integration.

11. One of the central constants is the *peace argument*. This is the idea that the integration of nation states will finally exclude any risk of armed conflict between them and will reduce the danger of attack from outside. The system is also designed to prevent milder forms of conflict, such as a return to 19th-century-style rivalries between the nation states and formations of alliances. The preferred pattern is integration, with its "control of all by all". An enlargement of the Union to the east makes this peace argument particularly easy to grasp. Almost all of the region in question has problems with minorities and the concomitant potential for conflict. For example, in relative terms, more Hungarians live in Hungary's neighbouring countries than there were Germans outside the Federal Republic when the country was divided (in each case, the ratio to the total number of Hungarians/Germans). Conflicts of interest which the treaties signed in and around Paris in 1919 were unable to resolve and which were suspended for 45 years after World War II under the Soviet dictatorship would, in an enlarged European Union, be given a chance to find a peaceful and lasting settlement.

12. Public perception is focused on the gains in economic efficiency. We might speak of the *internal market argument*. There is no denying that the removal of barriers for the free movement of goods and production factors fosters trade and increases welfare. Trade itself promises advantages, as does the related improvement in the division of labour. The same goes for the free movement of capital, labour and services and for freedom of establishment. However, we should also bear the following in mind:

- In terms of eastern enlargement, this sort of advantage can only come in the longer term. The western European taxpayer will initially have to send across billions in transfer payments.
- This also presupposes that any eastern enlargement will not simply extend deficient economic policies of the European

Union, such as the European agricultural market regulations, to include the acceding countries, thereby exacerbating their impact.

- When the markets are opened to the east, structural change will accelerate. This will bring both advantages and problems. The protection which is currently provided by the so-called Europe Agreements with the candidates for accession will disappear at some point in the future. And the markets for dependent labour, particularly in Germany, will be affected.

13. The *political arguments* are not restricted to the question of war and peace. Europe, the argument goes, should combine its forces to cope with the global challenges on the threshold of the 21st century. It should “have the will to be a world power”. In its Agenda 2000, the Commission says that, in view of the economic and geopolitical situation, the European Union will gain sufficient weight to play an important role in a multipolar world. This is particularly a matter of security policy, foreign trade policy and environmental policy. The question of how realistic such ideas are can be left open. But two reservations must be considered with regard to eastern enlargement:

- A gain in influence can, at most, be anticipated only in the long term.
- It cannot come without a solution to institutional problems within the Union. Otherwise, the eastern enlargement will instead tend to impair the Community’s ability to act.

14. One constant throughout the post-war development is the attempt to include Germany via European integration. We might term it the *German argument*. In the context of eastern enlargement, it takes the form of preventing Germany, which is probably the only country capable of conducting its own independent policy on eastern Europe, from doing so. This does not have to run counter to German interests. However, Germany’s interests must not be neglected when they are expressed as a part of European interests with the weight of Europe. Germany is not a small part of the whole. Without an eastern enlargement of the European Union, Germany could not avoid the role of economic partner of central and eastern

European countries. If Germany were to cooperate more closely with these countries, it would have to increase its financial commitment, although it would not have to go as far as it has in eastern Germany. This would substantially reduce the financial framework available for the European Union.

15. The aim of German policy, which vigorously advocates an eastern enlargement of the European Union, is to push the European poverty line as far to the east as possible. This is rather similar to the concept of safe third countries in terms of asylum: the idea of having neighbours to the east which are flourishing and which are institutionally linked with us via the European Union is regarded as a secular opportunity. With World War I, “Europe’s fundamental disaster in this century”, policy took the wrong direction. As a result, Germany in particular missed out on the great opportunities offered it by the century and brought down great misfortune on everyone. This cannot be changed. But perhaps, with the possibility of realising a peacefully united Europe, we can speak of a second chance.

16. French policy originally banked on a concept of concentric circles, with the traditional core Europe as the inner ring, surrounded by the other countries of the European Economic Area, and a third ring of associated countries. This concept was basically intended to keep aspiring candidates as far away as possible. It found no support, even within the European Union, not least because of the fairly blatant claim for hegemony of French policy. Such a claim would be easier to realise within the small group of countries at the core of Europe than within a large number of EU member states. France’s current intentions are not completely clear. Many people feel they can still perceive a policy aimed at delaying new members. This fits in with the insistence on “substantial reform of EU institutions” before any enlargement to the east can begin. But it may be the expression of a simple insight: club rules are easier to change before new members join than afterwards. On the other hand, there is no denying France’s interest in preventing Germany from embarking on an independent policy on eastern Europe.

17. Under both Conservative and Labour governments, Britain has always been a vigorous advocate of eastern enlargement. To the

### Country-specific aspects

British mind, an enlargement to the east will inevitably bring the European Union closer to a “superior free-trade zone”, the only concept which people on the other side of the Channel believe is both realistic and desirable.

The three north European member states are particularly interested in the earliest possible membership not only of Estonia, but also of the other Baltic states. They regard it as a desirable northern shift in the Union, stressing integration in the Baltic region.

The agreement to take up early negotiations on accession with Cyprus is due to Greek pressure. The hope is to overcome the current division of the island, even if no-one has yet come up with a practicable concept.

Spain and Portugal insist that eastern enlargement of the European Union must not be to the detriment of the southern countries. At the very least, a clear financial regulation is needed with a long-term arrangement for financial assistance for those countries that are currently weaker (which happen to include, apart from Greece and Ireland, themselves). In absolute terms, Spain is currently by far the largest net recipient of EU funding. Last year, this amounted to about DM 12 billion.

18. Whilst Russia, as the dominant successor state of the Soviet Union, is firmly opposed to eastern enlargement of NATO, it has no objections to an expansion of the European Union towards the east. The military potential of the Union, which at present is not organised on a Community basis anyway, is clearly taken far less seriously by Russia than that of the United States. Furthermore, the new orientation of Russian foreign policy comprises both greater proximity to Europe and independence in other areas (China, south Asia, Middle East). It is termed the Primakov doctrine. The partnership and cooperation agreement between the European Union and Russia, which was signed in June 1994 and entered into force in December 1997, is in line with this. In the view of the German Chancellor, it opens up a prospect of Russia later achieving the status of an “associated participant” of the European Union.

19. The United States is a very vigorous advocate of eastern enlargement of the European Union. Even though it is currently the only

genuine world power, it still has to rely on allies. A stable Europe is the natural partner on the other side of the Atlantic. Aspects of burden-sharing also play a major role in this connection. US policy urges the European Union to define itself less in cultural and historical and more in geopolitical terms, i.e. those of power politics. This makes the United States a firm supporter of full membership of the European Union for Turkey. Following this line, one would have to anticipate the possibility that the accession of Israel will one day become a political option.

20. It is probably as a result of the interests sketched out here that the eastern enlargement of the European Union has been placed on the 1998 political agenda. What is most surprising is that the political option of full membership is the only issue at stake. It is hard to forecast the length of the processes of negotiation. With regard to a few countries, people are speaking of a conclusion in 2002. For those who are looking to an enlargement comprising a total of eleven member states, 2010 is probably the earliest realistic date. The transitional phases for certain sectors would then extend far beyond that.

21. In the following paper, we analyse the main problems on the Union side. Following successful enlargement to the east, can the existing Common Agricultural Policy continue to exist in principle, or will it become impossibly expensive? Do the Structural and Cohesion funds need to be fundamentally reformed, or is it sufficient to modify them? How should the reform of EU institutions continue, following the failure in Amsterdam?

## II. Reforms in the European Union: The spending programmes

## 1. Need for Common Agricultural Policy reform

22. The intended enlargement of the European Union by five or, in a second round, a total of ten central and eastern European countries

creates substantial adjustment problems for agricultural policy, both in the acceding countries and in the existing member states. The agricultural policies are not mutually compatible. Within the Union, farm prices are kept high by means of so-called market regulations: supply is held down, imports are restricted and exports are subsidised. In addition, direct income transfers are paid out to the farmers. Due to its direct subsidies, to prices which lie far above the world market level, and to a distorted production structure, European agricultural policy causes high costs.

Agricultural prices in the central and eastern European countries, in contrast, are based on the world market level. The markets are open, and the level of subsidies is low. The agricultural sector has a far greater weight than in the European Union, especially in Poland and Hungary. To include the acceding countries whilst leaving the Common Agricultural Policy unchanged would confront the Union with insoluble financial problems. If the domestic prices in those countries are raised to the levels applying to the regulated products, there will be a danger of chronic production surpluses. In the acceding countries, the structure of incomes would shift strongly in favour of the farmers, to the detriment of the other earners.

Irrespective of the enlargement to the east, the subsidies to the farm sector in the Union need to be cut and the price distortions reduced. The agricultural policy accounts for almost half of the Union's budget. It is a burden on the overall economy and, because it has to be paid for by taxes, it exacerbates the employment problems. In addition, it provides a false incentive for farmers to opt for intensive cultivation, and thus creates substantial environmental problems. Experience shows that it is difficult to reintroduce market principles into this highly regulated sector.

23. High budget costs, trade distortions and some dissatisfaction with the development and distribution of incomes caused the European

## MacSharry-reform, first step in the right direction

Commission to reform the Common Agricultural Policy in 1992. The so-called MacSharry reform focused on a reduction in intervention prices for cereals and beef. Whilst it points in the right direction, the effect of the approach taken by this reform is considerably reduced due to the price refunds agreed for these regulated products. Even after the reform, the main factor behind the decision to cultivate cereals and oilseeds in many locations is not economic viability, but the prospect of subsidies. The impact of the MacSharry reform is also limited by the fact that it omits significant farm products. In particular, it does not cover milk or sugar, fruit, vegetables, wine or pork. This limited reform has been unable to produce satisfactory competition; in fact, it has created new distortions of competition. The MacSharry reform has been unable to reduce the size of the budget, and it has provided false incentives for the production structure. The winners from the reform are mainly farms covering large areas in relatively bad locations. In terms of their yields, they receive disproportionately high compensation via the premium system. In contrast, medium-sized farms in good locations with above-average yields are the losers under the reform.

## Increased pressure to reform

24. The reforms introduced in 1992 need to be continued and intensified, because the costs imposed by the agricultural policy on the overall economy are still too high, because the conditions of the Uruguay Round have still not been met, and because the farm sector will gain greatly in significance when the Union is enlarged to the east. The share of gross value added accounted for by agriculture in central and eastern European countries is roughly three times the level in the present European Union. It is true that agricultural production has declined in the acceding countries in the course of the process of transition. But these countries are traditionally net exporters of farm products, and they have a massive production potential. Opening up the European agricultural market would encourage these countries to substantially boost their agricultural output. In fact, in view of the comparative advantages, that would probably be a sensible economic development in an enlarged European Union. But the pressure on the system of market regulation and thus for further-reaching reforms will increase sharply.

25. Under the current system, the inclusion of central and eastern European countries in the Common Agricultural Policy would result in a substantial additional burden on the European Union budget.

However, the estimated annual budget costs presented by different experts vary considerably, depending on the assumptions made about the future level of agricultural production in central and eastern European countries, on which countries are taken, on the methodology used and on the time horizon considered. The European Commission has estimated the additional annual costs, if the Visegrad countries (Poland, Hungary, Czech Republic, Slovakia), the Baltic republics and Slovenia accede, to be ECU 12 billion. Other estimates assume an extra ECU 13 to 15 billion for the accession of the Visegrad countries alone.

Costs on this scale would represent a rise of nearly 40 % over the planned expenditure on agriculture for 1999. It should also be remembered that it is likely that further countries in transition in the east of Europe will join the Union in the next twelve to fifteen years. These countries would then also have to be included in the Common Agricultural Policy. In other words, a continuation of the Common Agricultural Policy under the current system would imply very high costs in future.

It is not feasible to exclude the new members in central and eastern Europe from the Common Agricultural Policy in the long term. That would mean that the new members would have to observe all the rights and obligations of the *acquis communautaire*, including the protectionist and production-restricting rules in the farm sector, whilst having to fund their national agricultural policy from their national budgets. Given the great significance of the farm sector for the economies of these countries, the national budgets would not be able to cope. This approach would run counter to all economic sense and to the justified interests of these countries in free access to the agricultural markets of their western neighbours and of third countries.

As was the case when the European Union was extended southwards to include Greece, Portugal and Spain, for which transition periods of up to ten years were stipulated, it has now been proposed that the farm prices of the new members be gradually raised to the prices of the Common Agricultural Policy during a long transitional phase. However, this would merely delay the additional burden on the Union's budget resulting from eastern enlargement. It is true that we can expect the share of gross value added produced by the farm

sector in central and eastern European countries to decline in the course of the process of transformation and as incomes rise. But in view of the productivity reserves in the farm sectors of the future EU members, any hope that the problems deriving from eastern enlargement will diminish over time seems unrealistic. A graduated adjustment of the agricultural prices in the new member states would necessitate a geographical differentiation in prices for farm produce during the transitional period. Without border controls, this would be impossible. Border controls would therefore have to be maintained between the existing member states and the acceding countries during the transitional phase. And, following that period, not only would the acceding countries have lost their sales on the world market, they would also be subject to the rigorous production restrictions of the Common Agricultural Policy. They would not even be able to engage in open competition within the European Union. The inefficiency and the costs of the Common Agricultural Policy would be exacerbated by the accessions. For this reason, an alignment with long transitional periods is not an acceptable solution either.

#### **Elements of the reform**

26. A reform of the agricultural market regulations of the European Union is a precondition for enlargement to the east. Changes within the existing market regulation system, e.g. via tougher controls on supply (quotas, set-aside premiums) will not resolve the problems. Such a policy would make the existing market regulations more inefficient, and it would not be compatible with the current rules of the World Trade Organisation (WTO). After all, the underlying objective of supply-side management in the farming sector is to maintain high support prices. In turn, high support prices necessitate high tariffs, since otherwise imports from third countries would undermine the price-support policy. According to the outcome of the GATT Uruguay Round negotiations in December 1993, the European Union must, by 2001, reduce the subsidised export quantities by 21 % from the annual average in 1986-1990. The quantities of the reference period had already been substantially exceeded in the period leading up to the agreement. In addition, the Union has promised to cut export refunds by 36 %. This will reduce the subsidised export of agricultural surpluses and clearly lessen the commercial advantages of exporting for the producers. According to the GATT decisions, the internal support must be reduced by 20 % by mid-2001. The amount of support derives from the difference between the internal market price in the European



Union and the world market price for the products, multiplied by the quantity supported, plus the product-specific and sectoral aids.

According to GATT/WTO rules, the level of external protection created by the founding or enlargement of a customs union must not be raised above the previous level. Even if one were to take the average of the old and new members of the European Union, the level of external protection for the current members would be reduced. It is expected that the scope for agricultural policy action will be further restricted in the next round of WTO negotiations, which are likely to begin in 1999, for example by a general ban on subsidies for agricultural exports. The European Union will not be able to fence itself off from the world-wide trend towards a liberalisation of the agricultural markets and thus towards a reduction in the misallocation of resources. It will not be able to avoid a fundamental reform of its agricultural policy.

27. The chief aim of the reform of the Common Agricultural Policy must be to reduce the support prices to such a degree that the supply-side regulation via quotas, set-aside premiums and other measures can be stopped, along with the subsidised export of surpluses. Instead of the introduction of agricultural market regulations and support prices in the acceding central and eastern European countries, the prices in the European Union should gradually be liberalised. This will make possible a major reduction in the Union's budget in the medium term, and will enable the central and eastern European countries to take advantage of their opportunities on the world market without any interruption. They can be expected to sharply boost their productivity and expand their world market share.

The farmers and their organisations will fight hard to block any reduction in and end to the support prices. The only area where this reform would not pose problems is the cereals sector since, following the MacSharry reform, the support prices have generally come down to the world market level. In the case of some cereals, world market prices have risen above internal market levels. For pork and poultry, a far-reaching drop in guaranteed prices should be politically feasible, because if the producers in this sector give up their support measures, they will be able to obtain feed corn at lower world market prices. However, there is likely to be considerable resistance in the

#### **Reduced support prices**

#### **New policy on compensatory payments**

case of milk and sugar, where the differences between world market prices and the guaranteed prices of the European Union are considerable, and a fundamental reform would encounter powerful political opposition, particularly in Germany. Yet this is an area where the prices in central and eastern Europe are substantially lower than in the Union, so that a reform appears more urgent for these products than the others. This is where there is likely to be the greatest pressure for a long transition period. The large price differentials go hand in hand with large cost differentials. The high costs in the Union are closely related to the inefficiency fostered by the complex quota regulations, the set-aside programmes, the production aids, the slaughter premiums, etc. Most farmers know that they would have to produce at substantially lower costs and that they could do so if the regulations were abolished. The structural change which has been held in check over recent years would take place faster if these reforms were introduced, but would also create additional adjustment problems for many farmers.

28. Whether or not the structural change acquires a new dimension due to eastern enlargement is debatable. But there is probably no avoiding temporary compensatory payments if genuine reforms are to be introduced. However, these compensatory payments should be decoupled from production. There is an underlying consensus that, should their countries become full members, farmers in the east of Europe should not have access to compensatory payments by the Union. However, in terms of equal treatment, this can only be justified if such payments in the existing European Union are tied to individuals and not to production. The potential new members in central and eastern Europe are not affected by a drop in support prices. It is therefore possible to do without compensatory payments to the farmers in the east of Europe without distorting the conditions for competition between the old and new members of the Union. There must be a time limit on the compensatory payments in the existing European Union. After all, the justification for these payments is to alleviate the hardships of structural change which fundamental reforms can be expected to bring.

29. Work must begin on tackling the reform of the Common Agricultural Policy before the central and eastern European countries join the European Union. Such reform is in any case neces-

sary, due to the commitments taken on in the Uruguay Round, under which the Union has to clearly cut the export subsidies, i.e. lower the guaranteed prices and align them with the world market level. Any administrative increase in the agricultural prices in the new members of an enlarged European Union would be incompatible with WTO rules; it would distort world agricultural trade. And there is another aspect: if the high guaranteed prices which currently exist in the Community of Fifteen were initially introduced into the acceding countries, it would be impossible to exclude the farmers in those countries from compensatory payments when prices are subsequently lowered. That would be very expensive.

30. In its Agenda 2000, the European Commission has announced further reforms – although these remain inadequate in overall terms. For example, the intervention price for cereals is to be cut by 20 %. This would reduce the protection against falling world market prices. The area-related compensation is to be increased and is to fall as world market prices rise. Compulsory and special set-aside is to be abolished.

For beef, the Commission proposes cutting the support price by nearly 30 % in 2000 and 2002. It assumes that this level can be maintained by external protection, export subsidies and storage. In compensation, the animal premiums are to be raised sharply.

For milk, the Commission recommends in Agenda 2000 that the support prices be cut by 10 % and a new annual payment of ECU 145 per animal be introduced for dairy cows, on top of the beef premium of ECU 70 per animal. The quota arrangement is to be extended. According to the current draft of the regulation, it is planned to cut the support prices by 15 %. The compensatory payments are to be set lower than initially envisaged, but the member states are to be able to specify the compensation arrangements.

The Commission's proposals aim to make agriculture more market-oriented again and to facilitate the integration of new member states. This intention merits full support, even if the compensatory arrangements are not yet defined clearly enough as subjective assistance and are not even subject to a time limit so far. The German government should give up its intransigent resistance.

### **The Commission proposals in Agenda 2000**

In fact, the Commission's proposals do not even go far enough. In important areas like the milk sector and sugar production, the problematic quota arrangements, guaranteed buying-in prices and premiums are retained. With regard to the planned enlargement of the Union, this is very bad because it takes the approach of introducing harmful and expensive intervention in new member states. The Commission is aware of the inadequacy of certain forms of market intervention. Regarding the rules for beef, it openly states that it is not feasible in the long term to clamp down on overproduction by paying premiums for the slaughter of calves which are a few days old and are then processed into meat-and-bone meal. Nevertheless, it does not propose ending this practice. This indicates how difficult it will be to fundamentally reform the Common Agricultural Policy instead of extending nonsensical intervention to new member states.

### **2. Need for structural policy reform**

31. Alongside agriculture, the Structural Funds account for a large proportion – over one-third – of European Union spending. The size of the Structural Funds has been disproportionately increased over the last decade. For the period up to 2000, the Commission proposes to boost the share of the budget allocated for structural funding up to about 37 % and the proportion of gross national product up to 0.46 %.

The envisaged enlargement places a question mark over the current structural policy. Going by the current criteria, and in view of the relatively low per-capita gross domestic products in the central and eastern European countries, the funding would have to be radically reallocated in favour of the new member states.

The structural policy of the European Union cannot be defined in terms of a uniform concept and a clear objective. Instead, it is the result of a rather impenetrable political decision-making process in which an important role is played by the desire to grab a slice of the cake and the exploitation of strong negotiating positions. That will always be the case. Nevertheless, it is still necessary to consider the possible aims and the appropriate means.

32. The intention of the regional and structural policy was to enhance macroeconomic growth. The underlying idea is that certain regions have a potential for growth which can be accelerated, or even sparked off, by state aids. The basic assumption is that such potential for growth is primarily to be found in the less developed regions. The ambitious concept of identifying potential for regional growth has proved to be fairly impractical. What has been left over is chiefly the understanding that regions need basic infrastructure if they are to exploit their commercial opportunities, and that projects which extend beyond regional borders need at least supra-regional coordination, and possibly supra-regional organisation.

A second objective is to alleviate radical or accelerated structural change and to support the transition to a different economic structure. The temptations to use subsidies to preserve inherited structures are sufficiently known. This makes it all the more important to alter the infrastructure, the zoning of land, and the regional assistance in order to stress new economic priorities.

Closely related to the policy of facilitating structural change is direct or indirect solidarity-based assistance, intended to stop incomes falling off too sharply. But, in principle, the structural and regional policy is not aimed at providing general social security for the inhabitants of a region.

33. In many cases, structural and regional policies are linked to attempts to align living standards. According to Article 158 of the new version of the EC Treaty, the Community aims to reduce disparities between the levels of development of the various regions and the backwardness of the least favoured regions, including rural areas. In particular, the regional development fund is tasked with helping to redress the main regional imbalances (Article 160 of the new version of the EC Treaty).

These objectives do not imply a right for the various regions to have an average per-capita gross domestic product or to receive transfer payments to bring them towards the average level in the European Union. That would neither be justified in social policy terms nor make economic sense. Just imagine the acceding countries being able to lay claim to this as soon as they became members of the

**Structural  
Funds: objectives ...**

European Union! If that were the case, there would probably be no eastern enlargement at all. Voluntary membership of the European Union presupposes that in principle all countries anticipate advantages from such membership and that no country is excessively called on to redistribute its wealth.

However, the objections to be made against a virtually complete alignment of incomes and other living standards go further. Any such concept would basically paralyse the efforts made by the regions and countries themselves. It would run counter to the differing conditions in the regions and the need for differentiation. It would be nonsensical and impossible to try to bring all aspects of living standards in the regions to the same level; after all, living standards are determined by a variety of factors, such as the availability of jobs, the regional wage level, the transport situation, the availability of culture, the climate, pollution, leisure facilities, etc. Living standards cannot be reduced to a single factor, such as per-capita gross domestic product, and individual people can attach very different weights to the various aspects. The comparison of individual elements can result in serious misinterpretations. A clearly higher level of wages and incomes than the average for the regions may be due to the advantages of conurbations. However, concentration in a small area brings not only advantages but also high real estate prices and costs of living, as well as other unpleasant aspects. In order to retain workers in that sort of region, it may be necessary to pay substantially higher wages than elsewhere, because the workers demand compensation for the higher costs of living. On balance, the individual worker may not necessarily be better off than his counterpart in a low-wage region.

The larger and more heterogeneous the European Union becomes, the greater the differences between the various regional factors will be. Lasting migratory movements provide an indicator of large differences in the overall package of living standards.

The objections to using support funding to align living standards are not directed against a minimum level of social security for individuals, although that too is first and foremost a matter for the regions or the member states and not for the European Union. Of course, in cases of hardship, the Union can grant direct aid to help individual regions. But the most important way to help is to give the companies in the

regions access to the common market and to permit people to move and work freely within the European Union. In other words: it is a question of equal opportunities, and not of equal economic results, results which each worker and entrepreneur can play a large part in determining themselves.

In order to overcome serious imbalances, public-sector investment and temporary assistance can and should help to tackle particular structural problems. But, again, this is chiefly a matter for the member states and not for the European Union.

One final point: the structural and regional policies are not well equipped to serve social policy purposes or to redistribute wealth. It is not the regions or the sectors that are poor, but the people. None of the programmes is based on the individual characteristics of the people and households. As mentioned above, there are good reasons why this task should primarily be reserved for local, regional or national level. This implies that only modest calls can be made for regional policy programmes at Community level, where they are justified in terms of redistribution of wealth, on the basis of Article 158 of the new version of the Treaty.

34. The Structural Funds of the European Union consist of the European Regional Development Fund, the European Social Fund, the Guidance Section of the European Agricultural Guidance and Guarantee Fund, and the financial instrument for fisheries guidance. Following the reforms of the Structural Funds in 1988, 1993 and 1995, the four funds are to concentrate on the following six objectives:

- *Objective 1*: promoting the development and structural adjustment of regions whose development is lagging behind;
- *Objective 2*: converting the regions, frontier regions or parts of regions seriously affected by industrial decline;
- *Objective 3*: combating long-term unemployment and facilitating the integration into working life of young people and of persons exposed to exclusion from the labour market;
- *Objective 4*: facilitating the adaptation of workers to industrial changes and to changes in production systems;
- *Objective 5*: promoting rural development by:

- speeding up the adjustment of agricultural structures in the framework of the reform of the common agricultural policy (Objective 5a),
- facilitating the development and structural adjustment of rural areas (Objective 5b);
- *Objective 6*: promoting the development and structural adjustment of regions with an extremely low population density.

The priorities of the policies using the Structural Funds of the European Union are determined via the definition of the chief objectives and the allocation of funding. It is clear from the objectives that the intervention concentrates on less-developed regions, since Objectives 1, 2, 5b and 6 are solely oriented to support for problem regions. In contrast, Objectives 3 and 4 (social and labour-market policy) and Objective 5a apply to the whole territory of the European Union.

The support criterion used for Objective 1 is per-capita gross domestic product. Regions whose per-capita gross domestic product is 75 % or less of the Community average are entitled to support under Objective 1. In the current 1994-1999 programming period, the eligible regions primarily comprise the entire territory of Greece, Portugal and Ireland, about 70 % of Spain, the Mezzogiorno, France's overseas départements, Corsica, Northern Ireland, Burgenland in Austria and eastern Germany. 26.6 % of the total population of the Union is enjoying the benefits of support under Objective 1 during the current six-year period.

No regions of the new members Sweden and Finland are covered by Objective 1. In the course of the negotiations on accession with the former EFTA countries Austria, Sweden and Finland, a new – sixth – objective was established. Under Objective 6, regions with fewer than eight inhabitants per square kilometre are to receive support. This new objective is specifically tailored to the sparsely populated polar regions in the new Scandinavian member states. This is a useful example of how the problems of a region cannot be satisfactorily embraced by the criterion of per-capita gross domestic product. In Sweden about 5 % of the population lives in Objective 6 regions, and in Finland the figure is about 17 %.

Support regions as defined in Objective 2 are regions with a high

level of unemployment, a high proportion of industry and a declining industrial workforce. However, these criteria are merely a necessary, and not an adequate, condition for support under Objective 2. The eligible regions are proposed by the member states and, after the Regional Development Committee has been heard, are designated by the Commission for a period of three years. Here, it must be noted that Objective 1 regions cannot also receive support under Objective 2. Portugal, Greece and Ireland cannot therefore claim any Objective 2 support for themselves. In the current programming period, roughly 60 out of more than 900 regions have been deemed eligible for Objective 2 support. 16.4 % of the total population of the European Union lives in Objective 2 regions.

Objective 5b covers regions with a low level of economic and social development. However, in contrast to Objective 1, no threshold for per-capita gross domestic product is stipulated. As well as having a low level of development, the eligible regions must also fulfil at least two of the three following criteria:

- a high proportion of the workforce in agriculture;
- a low income level from agriculture;
- a low population density or a trend towards depopulation.

In addition to this, there are a number of secondary criteria, most of which are highly open to interpretation. Like Objective 2 regions, Objective 5b regions are designated by the Commission for a period of three years, following a proposal by the member state and a hearing of the relevant fund committee. Objective 1 regions are not eligible. At present, 8.8 % of the total population lives in Objective 5b regions.

Support funding under Objectives 1, 2, 5b and 6 is granted only in the form of co-funding of member state regional support. This mirrors the basic thrust of policy on the Cohesion Fund, which aims at additional support – on top of national efforts – for less-developed regions. The rates of co-funding in the various regions are based on the severity of the regional and social problems, the financial strength of the respective member state, its relative welfare position and the particular Community and regional interest in the measure supported. In Objective 1 areas, the co-funding rate is at least 50 % and at most 75 %. In member states where the per-capita gross

domestic product is less than 90 % of the Union average (so-called “cohesion countries”), the Community share can be increased to 80 %, and it can reach 85 % in regions on the extreme peripheries. In all other regions covered by objectives, the co-funding rate is at least 25 % and at most 50 %.

There are no explicit support criteria for Objectives 3 and 4 (social and labour-market policy) or Objective 5a. All appropriate member state programmes are in principle eligible. Following an application from the member state, the funding is awarded in the form of so-called Community support frameworks.

35. The financial perspective proposed by the Commission and adopted by the Council of Ministers provided for a total of over ECU 150 billion (in 1994 prices) for the Structural Funds in the 1994-1999 period. This equates to an average share of just under 31 % of the total budget of the European Union, the share gradually rising from 28.8 % in 1994 to 32.6 % in 1999. In 1999, the guideline of 0.46 % of the European Union’s gross national product as set by the European Council at the end of 1992 is to be attained for the Structural Funds.

36. The structural funding is distributed between the various objectives, the member states and the regional support programmes via an extremely complicated procedure. The untransparent procedure has been repeatedly altered during the last three programming periods.

In a *first step*, the Commission allocates the structural funding to the respective objectives of the Structural Funds, taking into account the stipulations of the Council of Ministers. There are no objective criteria for this allocation; it is ultimately the outcome of a process of political negotiation. In the current 1994-1999 programming period, there is a clear focus on the regional policy Objectives 1, 2 and 5b (table 1).

In total, over 77 % of structural funding is spent on regional policy measures. The focus is on Objective 1 support for substantially less-developed regions. The proportion of Objective 1 support is rising from 65.7 % in 1994 to 70.4 % in 1999.

**... funding levels ...**

**... and instruments**

<b>Table 1: Support from the Structural Funds in the Community of Fifteen, 1994-1999</b>	
<b>Objective</b>	<b>Share (%)*)</b>
Objective 1	68.0
Objective 2	11.1
Objectives 3 and 4	11.0
Objective 5a	4.4
Objective 5b	5.0
Objective 6	0.5

\*) Proportion of the Structural Funds allocated to Objectives 1-6

Source: Council of Economic Experts, 1997/98 annual report, table 66, p. 239

In the new member states of Austria, Sweden and Finland, Objectives 3 and 4 (social and labour-market policy) are of greater importance, accounting for 26 % of the total support. But even in these countries (not least due to the new Objective 6), regional policy intervention plays a major role, accounting for 47 %.

In a *second step*, the Commission, in coordination with the Council of Ministers, stipulates indicative allocations of the total funding for the various member states under Objectives 1 to 4 and 5b. According to the Framework Regulation, the breakdown of the funding between the member states must take place using “transparent procedures”, particularly taking as criteria the “national and regional prosperity”, the population and the (regional) unemployment rate (Article 12, paragraph 4 of the Framework Regulation). In practice, this process is extremely untransparent. The criteria actually applied are not disclosed; there is no specific formula for distribution. There is a striking discrepancy between distribution processes at national and European level. Whilst the European Commission imposes specific criteria on national governments regarding the eligibility of national programmes, it is apparently not interested in imposing any objective requirement on itself regarding the distribution of the structural funding amongst the

member states. This suggests that the allocation of structural funding to the member states is ultimately the product of a (distribution-oriented) political negotiation process.

Overall, the support funding is roughly equally divided between member states with average or above-average per-capita gross domestic products and those which fall below the average. A greater difference can be seen between the regional policy measures (Objectives 1, 2, 5b and 6) on the one hand and the social, labour-market and agricultural policy measures (Objectives 3, 4 and 5a) on the other. Whilst the member states with below-average per-capita gross domestic products benefit disproportionately from regional policy measures, at 57.6 %, their share of other support funding is only 11.8 %. This is primarily because Objective 1 regions cannot at the same time receive support under other Structural Fund objectives.

In a *third step*, the member states are called on by the Commission to present regional development plans for Objectives 1, 2 and 5b and horizontal (national) plans for Objectives 3 and 4. These plans must include a socio-economic analysis of the regional/sectoral problems, the national development strategy chosen, the key areas of support to be funded, and the structural funding applied for. The plans presented are then examined and assessed by the European Commission.

In a *fourth step*, the Commission establishes a Community support framework on the basis of the national development plans and following negotiations with the member states and a hearing of the relevant fund committees. The Community support frameworks stipulate the final priorities and forms of intervention in the respective member states. A central element of the Community support framework is a funding plan, allocating structural funding under Objectives 1 to 4 and 5b.

Objective 5a support does not follow the four steps listed above. Here, the funding is primarily allocated in line with the “degree of utilisation of resources during the preceding programming period”. In addition, as secondary criteria, “specific structural needs of agriculture and fisheries” are also considered (Article 12 paragraph 4 of the Framework Regulation).

In a *fifth and final step*, the so-called operational phase, the financial framework stipulated in the Community support frameworks is fleshed out in various forms of intervention, such as the co-funding of national programmes. Since the Community support frameworks only represent a declaration of intent – albeit a politically binding one –, the funding is not actually tied to a particular measure until the Commission specifically authorises an intervention.

37. In addition to this, the European Commission adopts so-called Community initiatives on its own responsibility. It provides funding for special structural and regional policy measures such as “cross-border cooperation”, the development of “ultraperipheral” regions or the “diversification of fisheries regions” and thus supplements the normal support programmes. In the current programming period, up to ECU 13.5 billion is reserved for Community initiatives – or 9 % of all structural funding. The Commission decides itself how to allocate the funding amongst the member states. Via its Community initiatives, the Commission is now running some 400 programmes and is taking care of, for example, street lighting in various towns, kindergartens and the establishment of town twinning partnerships, as well as helping individuals to modernise their own homes.

#### **Community initiatives**

38. Under the Maastricht Treaty, a Cohesion Fund was established, which, as mentioned in the Preamble of the Cohesion Fund Regulation, is to enable member states with a per-capita gross national product of less than 90 % of the Community average to meet the convergence criteria provided for the transition to the third stage of economic and monetary union. The Cohesion Fund only supports cross-border (“trans-European”) projects in the fields of environment and transport infrastructure. In the 1993-1999 period, Greece, Portugal, Spain and Ireland are eligible. Unlike the Structural Funds, the criterion of eligibility refers to nation states and not to regions. The funding from the Cohesion Fund is allocated amongst the eligible member states on the basis of population, per-capita gross domestic product, size of territory and other socio-economic factors, such as inadequate transport infrastructure. For the 1993-1999 period, the Cohesion Fund has been given a total of ECU 15.15 billion (in 1994 prices). The initial amount of ECU 1.5 billion for 1993 was

#### **Cohesion Fund**

increased by an annual ECU 250 million until 1997. For 1998, ECU 2.55 billion is planned; the 1999 figure is ECU 2.6 billion.

The funding from the Cohesion Fund is distributed annually among the eligible countries. On the basis of the above-mentioned criteria, the Commission has stipulated that Spain should receive 52-58 %, Greece and Portugal both 16-20 % and Ireland between 7 and 10 % of the annual support. In past years, the cohesion countries have each received an amount in the middle of the range available. The Cohesion Fund deliberately dispenses with the principle of additivity. The co-funding by the member states of the projects supported by the European Union using the Cohesion Fund is therefore about 15-20 % lower than is the case with the Structural Funds.

39. It is hard to keep tabs on the way the funding is allocated under the various Structural and Cohesion funds. In practice, it has become clear that support based on uniform criteria takes insufficient account of the special characteristics of the individual regions. The levels of per-capita support from the Structural and Cohesion Funds together show that the European Union is chiefly guided by the relative per-capita gross domestic products. The ratio of support funding to national gross domestic product points in the same direction (cf. table 2). This also shows how great the impact of the supplementary funding from the Cohesion Fund is, which only benefits Greece, Ireland, Portugal and Spain.

#### **Reforms inevitable**

The Community support frameworks involve a lot of administration, because they are established and then jointly implemented in a complex process involving the member states and the European Commission. Both the Objective 1 areas and the cohesion countries demonstrate that once support has begun, it is virtually impossible to rein it in. A lot of imagination is devoted to preserving the supposed privileges.

40. The same applied to the way eastern Germany was dealt with. The relevant per-capita gross domestic product in eastern Germany stood at between 30 and 40 % of the Union average, i.e. well below the 75 % threshold. Accordingly, the entire area of eastern Germany should have been included as an Objective 1 area in the support for the 1994-1999 programming period, as indeed it was. But attention was also paid to the preservation of entitlements elsewhere.

<b>Table 2: Relative distribution of structural and cohesion funding in the Community of Fifteen, 1994-1999</b>			
	<b>Per-capita GDP in 1997 (%)<sup>1)</sup></b>	<b>Per-capita support (ECU)<sup>2)</sup></b>	<b>Ratio of support to GDP (%)</b>
Luxembourg	175.4	37	0.15
Denmark	142.3	25	0.14
Germany	120.3	42	0.25
Sweden	118.4	32	0.21
Austria	113.7	40	0.23
France	111.7	37	0.21
Belgium	109.0	31	0.17
Netherlands	106.8	23	0.14
Finland	104.8	67	0.47
UK	97.6	29	0.19
Ireland	93.8	334	2.60
Italy	92.4	60	0.37
Spain	62.7	171	1.39
Greece	52.6	279	2.79
Portugal	46.3	298	2.73

1) ECU; at respective market prices; EU average = 100  
2) Average annual support  
Source: European Commission

First of all, there was a political decision that the 75 % criterion for per-capita gross domestic product under Objective 1 should exclude eastern Germany. Member states even went a step further in the way they clung onto benefits. In the new programming period, no region was removed from the support scheme, even though the per-capita gross domestic product had risen to up to 92 % of the Union average (excluding eastern Germany) in certain regions. Britain and the Netherlands even managed to include the Highlands, Merseyside and Flevoland as new supported regions, although they did not meet the 75% criterion and the statistical definition of the regions was dubious.

In other words, the enlargement of the European Union to include eastern Germany, where the per-capita gross domestic product was lower than in any other region, did not result in other regions in the European Union being removed from the scheme. On the contrary, the supported areas were extended. Despite the inclusion of eastern Germany, their funding entitlements were also increased in financial terms. Compared with the previous 1988-1993 programming period, the structural funding was almost doubled in real terms for the 1994-1999 period, to ECU 141.5 billion (in 1994 prices).

The vastly increased funding was not distributed on the basis of uniform and transparent criteria. Going by the population located in Objective 1 areas, the funding provided for eastern Germany under that objective, which totalled ECU 13.6 billion for 1994-1999, should actually have been roughly 50 % higher. If we were to take the relative per-capita gross domestic product, we would arrive at an even higher figure. In practice, the objective criteria played virtually no role in determining the amount of funding for eastern Germany. Ultimately, the level of funding for the acceding area of eastern Germany was negotiated politically in the Council of Ministers and through many informal channels.

The fact that, on the occasion of the first “eastward enlargement” to include eastern Germany, the support from the Structural Funds turned out to be lower in the new area than in comparable regions in Italy, Portugal or Greece is not necessarily to be regretted. There are many arguments in favour of not automatically extending the support from the Structural Funds to new members, and instead of viewing it as aid deriving from a particular regional and political situation which should in principle be reduced again. What is bad, on the other hand, is the inflexible designation of regions and the excessive increase in the volume of support.

41. Without a timely reform of the Structural and Cohesion Funds, it must be expected that some member states will make their approval of the eastern enlargement dependent on a preservation of the privileges of those areas already receiving support and that they may even try to increase the support further. However, since the acceding countries cannot be excluded from the support funds, the burden on the Union’s budget will grow even more. Under the current support criteria, not only the current candidates, i.e. Poland, the Czech Republic, Hungary, Slovenia and Estonia will be eligible, but also the



countries following on in the next round: Romania, Bulgaria, Slovakia, Latvia and Lithuania.

Not all the difficulties for structural and regional support resulting from eastern enlargement will derive from the rising expenditure. It will also become more and more difficult to use uniform, centralised programmes to address the special characteristics of the regions. Greater attention will therefore have to be paid to which tasks are done better at national level, in line with the principle of subsidiarity, and where there is still a need for the European Union to act. These questions must be addressed prior to the next round of enlargement, so that the support frameworks are not extended to include additional countries, thus creating fresh desires to retain entitlements. The changing attitude of the representatives of the candidates for accession is already clearly apparent. Whereas, four or five years ago, they were still emphasising that they were mainly interested in political integration and access to the internal market rather than in structural funding, they now state quite plainly that they wish to be included in structural and regional support under the current rules.

42. At the heart of the reform of the Structural Funds proposed in Agenda 2000 is a reformulation of the support objectives. The number of objectives is cut from seven to three, whereby two of the objectives will have a regional orientation and one will be focused on training and the labour market. The Objective 1 support for less-developed regions will be continued unchanged. As in the past, roughly two-thirds of the structural funding is to be reserved for this objective. A new Objective 2 will bring together the measures benefiting other regions with structural problems which were previously divided between the old Objectives 2, 5b and 6. The objective will cover regions in which structural change is taking place in the industrial or services sectors, less-developed rural areas, areas in crisis which are dependent on fisheries, and deprived urban areas. The programmes under the new Objective 2 are to concentrate on vocational training, the local development potential, environmental protection and tackling "social exclusion". In particular, investment in the formation of human capital is to be fostered and the innovative potential of the regions enhanced. The criteria for the support will include socio-economic aspects like the unemployment rate, the level of employment in industry, agriculture and fisheries, and

#### **The Commission proposals in Agenda 2000**

the "degree of social exclusion". The current Objective 2 and Objective 5b areas which cease to be eligible under the new criteria are to receive limited financial support during a transition period.

A new horizontal Objective 3 is to help the member states to adapt and modernise their education, training and employment systems. In particular, it is aimed at:

- facilitating economic and social change,
- lifelong education and training,
- active labour-market policy and
- tackling social exclusion.

In addition, Agenda 2000 intends to reduce the number of Community initiatives from 13 to 3 and their share of the structural funding from 9 to 5 %. Priority is to be given to:

- cross-border transnational and interregional cooperation aimed at harmonious and balanced regional planning;
- rural development;
- human resources in the context of equal opportunities.

According to the Commission's ideas, the *Cohesion Fund* is to be retained at its present level. The only new point is that there is to be no review of whether the countries to be supported from the Cohesion Fund actually meet the 90 % criterion until the middle of the coming programming period. Everyone knows that Ireland's per-capita income is already above the EU average, and that the country does not meet the preconditions for support.

The funding for the 2000-2006 programming period, including the funding for the acceding countries, is to be increased to a total of ECU 275 billion (at 1997 prices). That is an increase of 20 % in real terms over the average annual funding available in the 1994-1999 period. This assumes that the share of structural funding can be increased from 0.41 to 0.46 % of the European Union's gross domestic product. The potential new members are to be allocated a total of ECU 45 billion for the 2000-2006 programming period. In order to prepare for accession, these countries are initially to receive ECU 1 billion from 2000; the annual volume of support is to increase to ECU 12.6 billion

by 2006.

43. The European Commission's proposal that the *Structural Funds* be concentrated on three objectives certainly points in the right direction. But a closer look reveals that virtually all the existing aims have been retained and new ones even added. The Objective 3 fund provides hints of a European employment policy, because in the view of the Commission a priority should be placed on access to employment, lifelong learning, the promotion of local employment initiatives, including regional and municipal employment alliances – measures which, according to the principle of subsidiarity, are not the responsibility of the European Union. No systematic attempts at reform, or at a convincing justification for the support activities of the European Union, are apparent. It is particularly surprising that the Commission proposes retaining the Cohesion Fund unchanged, even though the Fund is limited until 1999 according to the decisions taken so far.

Even though the structural and regional support is basically to be continued unchanged and to be given even more funding, the question of whether the central and eastern European countries are to be fully included in the system is left unanswered. The level of overall funding has been increased in real terms, but it can only be adhered to by ensuring that the average maximum level of support in 1999 in the existing member states is not increased any further during the new programming period and is even reduced by about 10 % in the run-up to 2006. The candidates for accession would be able to increase their share of the expanding overall framework from just under 3 % in 2000 to almost 30 % in 2006. However, they would then still be receiving a clearly lower level of support than Ireland, Spain, Portugal and Greece. It therefore seems rather unlikely that it will be possible to keep within the proposed financial framework (despite the 20 % increase), because the new members will demand equal treatment under the scarcely altered support rules and the other member states will insist on their support staying at least at the same level. The European Commission does not address this problem, which, in the figures of Agenda 2000, only manifests itself at the end of the next programming period.

44. Going beyond the hesitant attempts at reform in Agenda 2000, there is a need for fundamental changes in structural and regional

policy as early as the coming programming period.

- Support under the Cohesion Fund should end, as planned, in 1999. The task of helping the countries with weaker economies to meet the convergence criteria has in any case become obsolete for those countries participating in monetary union.
- The Community initiatives should not be continued, but should be replaced by a small contingency fund for unforeseen emergencies and made part of the general Structural Funds. The limited tasks proposed at present (cross-border transnational and interregional cooperation, rural development, human resources in the context of equal opportunities) should be left to the member states or similarly integrated into the general funds and thus subjected to the control of the Council of Ministers.
- The overall framework for the Structural Funds should be tightened up. Funding totalling 0.46 % of the gross domestic product appears too high. The idea of using support programmes to mobilise potential for growth in the regions and to accelerate economic development in regions with a low per-capita gross domestic product has not really proved workable. The concept of growth stimulation has increasingly been displaced by a political battle to redistribute funding, and this is at least partially due to the fact that neither the potential for growth nor the impact of the support on economic development can be clearly defined. Instead of including areas covering over 50 % of the population of the European Union in structural and regional support schemes, it would be better to give the member states greater responsibility and to rely more on competition between the regions. The Commission's proposal that no more than 35 to 40 % of the population should be covered is still not ambitious enough.
- The Structural Funds should be merged, substantially simplified and focused more on cross-border measures. These include an expansion of trans-European infrastructure networks, as long as this is not misused as a make-work scheme but adheres to cost-benefit criteria. In addition, the European Union will have to respond to hardship cases and help where there are severe imbalances. Since, according to the principle of subsidiarity, it is primarily up to the member states to act themselves, it is

### **Further-reaching proposals**

worthwhile restricting the support, e.g. to regions which fulfil a twofold criterion, i.e. that they are in member states whose per-capita gross domestic product is less than 90 % of the Union average, and that they themselves fall more than 30 or even 35 % below this average. These criteria could be supplemented by the requirement that the unemployment rate be more than 50 % above the European average, that the support funding amount to no more than 3 % of the regional gross domestic product, and that the member state provide at least 40 % of the funding.

- All support measures should be subject to a time limit. Instead of including the central and eastern European countries in the existing support frameworks, it would appear sensible to give them help to prepare for accession as planned, and then to continue this support in the form of an integration fund for a few years after accession. This would allow the particular transitional problems of the individual new members to be addressed.

45. All sides involved must be clear that without a fundamental reform of the Common Agricultural Policy and the Structural Funds, eastern enlargement would break the overall budget of the European Union. The payments to agriculture and the payments through the Structural Funds already account for the bulk of the Community's expenditure. If the policy of transfers was extended to include the new candidates for accession, and later the rest of the countries in transition which applied to join, expenditure under status quo conditions would run out of control. It is true that some member states, and particularly those which have so far received a lot of financial assistance and do not wish to lose it in future, are considering increasing the European Union's financial framework from the current level (set until 1999) of 1.27 % of the Community's gross national product. However, with good reason, this will not achieve a consensus. Budgetary decisions at Community level need to be taken unanimously. Germany has already stated its clear opposition to any raising of the ceiling on Community revenue. The European Commission should continue not to have the right to borrow money to finance its budget. Any other approach would not be in line with the objective announced by governments both in Germany and in other member states to cut the ratio of public-sector spending to gross national product in the medium term and to reduce the burden of taxes and charges. The requirement that the

**No increase in the financial framework**

budget be consolidated and sustainable and that public-sector finances be sound (which, we should note, also applies to European Monetary Union) must be reflected at European level in an absolute desire to keep spending down. Anything else would be very hard to explain to the public – and would not make economic sense.

The debate that keeps on flaring up in Germany about fair burden-sharing in the European Union could be damped down by a reform of the spending programmes. The orientation of the contributions of the member states to the level of gross national product is generally regarded as appropriate. The anger derives from the net contribution – more than DM 20 billion a year – which Germany transfers to the European Union. The criticism therefore has to be directed at the nature and size of the spending programmes, including the yardsticks for distribution amongst the member states. The fact that this debate focuses so strongly on the net contribution and that this leads to overhasty conclusions about costs and benefits of membership of the European Union is less than helpful. Calculations of the payments made and the amount of money returning pose problems, not least in terms of methodology. According to estimates by the Council of Economic Experts, about 25 % of the budget revenues and approximately 40 % of the expenditure of the European Union cannot be clearly ascribed to individual member states. Where the transactions can be unambiguously ascribed to a member state, it can be assumed that the level of payments to the Community is more or less in harmony with the strength of the relevant economy (in terms of national per-capita gross domestic product) and that the corresponding (reverse) ratios on the expenditure side are also generally in order. However, the way the funding is distributed amongst the member states is to a large extent dependent on the focuses of the spending programmes and the economic structure of the individual member states. For example, the funding from the expensive agricultural fund primarily goes to member states with a large farming sector. Eastern Germany was included in the regional development fund in 1994 – but Germany opted against a level of per-capita support equal to the other Objective 1 countries so as not to burden the other member states so greatly with the costs of German reunification.

Like the other member states, Germany derives major economic benefits from the intensified division of labour in the single

European market. It is hard to put a figure on these benefits, but they are undeniable. Certainly, a comprehensive review of costs and benefits of European Union membership produces a different message from that implied by merely totting up and offsetting payments. Nevertheless, the German government is endeavouring to ensure that the burden on Germany will be reduced in next year's consultations on financial planning for the 2000-2006 period, in order – so the argument goes – to take account of the fact that due to reunification the country's per-capita income has declined in relative terms. There is talk of capping and rebates (along UK lines). It may be the case that a totally new financing mechanism will have to be worked out, because other net contributors (currently Italy, Britain, the Netherlands, Sweden) are complaining about unfair burden-sharing and no-one wishes to risk a decline in popular approval of European integration. All this shows clearly that it would not be feasible to increase the financial framework in the context of eastern enlargement.

### III. Reforms in the European Union: The institutions

46. A substantial enlargement of the Community implies a need to reform its institutions. With each enlargement, the heterogeneity and the related differences in interests within the Community will increase. There is a danger that the further development of the Community would be rendered far more difficult if the enlargement did not go hand in hand with a reform of the institutions which safeguards their functioning and ensures a balance of power between the larger and sometimes very small countries.

The institutions of the Community were originally designed for a

#### **Status quo after Amsterdam**

Community of Six, and the Commission or the Council are already stretched to their functional limits in the Community of Fifteen. Without a reform of the political institutions, it will be impossible

to cope in organisational terms with the envisaged enlargement, firstly to include the five central and eastern European countries and Cyprus in a Community of Twenty-one, and later even to create a Community of Twenty-six. The theory of organisation tells us that the ability of an institution to function diminishes progressively once the optimal size of the institution is exceeded. The larger an institution is, the longer its meetings become, because it grows increasingly difficult to achieve a consensus. There is a tendency to form groups and to shift the preparation of decisions into circles outside the official forum. This results in a lack of transparency and a reduction in the readiness to reach agreement. Ultimately, the decision-making process itself suffers. Even if decisions are not blocked, there are delays and attempts to dominate individual members; in the end, less far-reaching decisions are taken.

47. However, the reform of the institutions is not aimed just to maintain the ability of the Community institutions to function. Instead, it is also a question of an appropriate division of decision-making powers between the large and the smaller member states. So far, it has been possible to retain a certain balance of power between the large and small members. This will have to be redefined when enlargement takes place because, with the exception of Poland, virtually all the candidates for accession are, in population terms, small or very small countries. The first six candidates are Poland (38.5 million inhabitants), the Czech Republic (10.3 million), Hungary (10.1 million), Slovenia (1.9 million), Estonia (1.5 million) and Cyprus (0.7 million). The other candidates include Romania (22.7 million), Bulgaria (8.4 million), Slovakia (5.4 million), Lithuania (2.7 million) and Latvia (2.6 million).

It is impossible to predict how many countries will eventually belong to the European Union. It is therefore also impossible to initiate an institutional reform which can cope with every imaginable case. European unification is an open process. Therefore, there can be no blanket responses; rather, the Community will repeatedly be faced with the question of whether and how its institutions should be altered when new countries come on board.

48. The Intergovernmental Conference of Amsterdam in June 1997 largely failed to find answers to these questions. The conclusions of the Luxembourg Summit of December 1997 merely contain a meaningless item expressed in convoluted diplomatic language. The political concept is to implement institutional reforms at the same time as the current negotiations on membership. Since the first membership agreements are not expected before 2002, a certain amount of time is available. The current debate has narrowed down to three issues which Belgium, France and Italy highlighted as deficiencies in a declaration which was taken note of by the Amsterdam conference: the composition of the Commission, the weighting of votes within the Council, and the expansion of qualified majority voting in that body. Since the European Central Bank will begin its work following the start of monetary union in 1999, it will also be necessary to clarify how the Central Bank Council's ability to function can be safeguarded following enlargement.

49. However, Amsterdam also resulted in a new additional approach to integration, beyond the existing special cases, which is intended to foster deeper cooperation in parallel to enlargement. This is a concept of flexibilisation based on differentiation and graduation. The underlying idea is that individual member states should not be hindered from further integration when other member states are not yet prepared to accept the corresponding loss of sovereignty or would be unable to cope with the deeper integration. The flexibility-based approach to integration represents a partial response to the particular problems resulting from an extensive enlargement of the Community to include less developed countries. However, the flexibility concept can only be applied to certain fields. Articles 43 to 45 of the new version of the Treaty on European Union adopted in Maastricht stipulate how to apply this flexibility. The main field covered falls within the Common Foreign and Security Policy (CFSP). Member states wishing to remain outside such intensified cooperation do not have any right of veto with which to block the integration desired by other member states. In the field of cooperation on police and justice, on the other hand, they can use their veto to prevent such integration (Article 40 of the new version of the EU Treaty).

#### **Flexibility and enhanced cooperation**

#### **The Commission**

50. Some aspects of the flexibility concept have also found their way into the EC Treaty (as distinct from the EU Treaty) which regulates the core area of European integration (Article 11 of the new version of the EC Treaty). However, the preconditions for closer cooperation between a sub-set of member states are extremely restrictive. Once again, the non-participating countries have a right of veto. In fact, there are hardly any fields in which the flexibility of differentiated cooperation can be applied here. It is possible that environmental policy is an appropriate field.

51. The Commission currently consists of 20 members. Each member state provides one representative, and the larger countries have two. If this rule is not amended, the envisaged enlargement to include an initial six additional countries will boost the number of Commission members to at least 26. Some member states believe that this is viable and advocate the retention of the current system. However, such an enlargement would disproportionately increase the number of Commission members from small countries compared to those from larger countries.

No decision was taken in Amsterdam about a change in the composition of the Commission. However, a declaration of intent was adopted on a reduction in the size of the institution, the idea being that each member state should only be permitted one Commission member. The five member states with the largest populations would lose the right to appoint a second member. There is a link between this and attempts to alter the weighting of votes in the Council (figure 53).

52. However, the efficiency of the Commission is impaired not only by the large number of members but also by the fact that each member of the Commission is entrusted with a distinct portfolio. This has resulted in portfolios being split up, leading to overlapping responsibilities, lack of transparency and friction. The question is whether efficiency could be enhanced by concentrating the tasks amongst a smaller number of Commission members. Nor would every commissioner have to have a distinct portfolio. This would be a useful extension of the provision that the members of the Commission shall in future be appointed in agreement with the designated President (Article 214 paragraph 2 subparagraph 2 of the new version of the EC Treaty). Commissioners without portfolio would still have an equal say in decisions taken by the Commission.

53. Each country is represented in the Council. However, the votes of the member states are weighted differently, roughly in line with their relative size (cf. table 3). At present, the threshold for the most politically important case of qualified majority voting – when a decision is to be taken on a Commission proposal – is 62 out of 87 votes. In other cases of majority voting, the 62 votes must also comprise the approval of at least 10 of the 15 member states. Both rules on majority voting will need revising when the Community is enlarged. It would make sense to replace them with a single rule, i.e. to abolish the less stringent voting procedure for Commission proposals.

In Amsterdam, decision-making by qualified majority was extended to include certain new areas of the Treaty, such as the guidelines on employment policy, and a few existing Treaty provisions, such as research policy. These decisions reflect the efforts to extend the principle of majority voting as far as possible. However, there are core areas where the unanimity principle cannot be relinquished – particularly issues of the European monetary system and the system of Community finances.

54. On the other hand, it proved impossible to reach agreement on a fundamental reform of the weighting of votes at Amsterdam. This reform will be inevitable as soon as new members from central and eastern Europe join the Community. In the “Protocol on the institutions with the prospect of enlargement of the European

### The Council

<b>Table 3: Weighting of the votes in the European Council of the Community of Fifteen</b>					
	<b>Number of votes</b>	<b>Population (million)</b>		<b>Number of votes</b>	<b>Population (million)</b>
Germany	10	81.338	UK	10	58.276
France	10	57.779	Italy	10	57.139
Spain	8	39.117	Netherlands	5	15.342
Greece	5	10.410	Belgium	5	10.102
Portugal	5	9.887	Sweden	4	8.745
Austria	4	8.015	Denmark	3	5.197
Finland	3	5.078	Ireland	3	3.569
Luxembourg	2	0.401	<b>Total</b>	<b>87</b>	<b>370.395</b>

Union”, a link is made between a reduction in the size of the Commission and a revision of the weighting of votes in the Council. An alternative is given: a fresh weighting of the votes of large and small countries based on the existing arrangements, together with the introduction of a “double majority”. The double majority procedure means that a qualified majority of national votes – currently 62 of 87 – must also comprise a qualified majority either of the number of countries – currently 10 of 15 – or in terms of population figures.

55. So far, it has not been customary to bring the voting arrangements more into line with population figures. However, as more very small countries join the Community in the course of eastern enlargement, it makes sense to introduce the population criterion and to conduct all majority decisions on this double basis. Greater orientation to population figures would put an end to the unsatisfactory circumstance that inadequate consideration has so far been given to the relative sizes of the countries in the voting procedure. Giving consideration to population figures would tend to lend the voting procedure a desirable, more democratic legitimacy.

The definition of blocking minorities must also be reviewed. At present, no decision is adopted if three of the four larger member states (Germany, France, Italy, UK), each of which has 10 votes, are against a proposal. The same is generally true when two large member states are joined by two smaller ones. At least with regard to the first blocking minority, nothing should change. In the second situation, it may be appropriate, assuming numerous smaller countries join the Community, to require a larger number of smaller countries.

56. In order to safeguard the functioning of the European Parliament, the Treaty of Amsterdam has imposed a ceiling of 700 on the number of its members in the light of the coming enlargement of the Community. The electoral procedure is also to be harmonised. With regard to the Parliament’s participatory rights, its position has improved in two ways: the unanimous appointment of the President of the Commission by the governments of the member states shall in future require the approval of the Parliament (Article 214 paragraph 2 of the new version of the EC Treaty). Also, the scope of application of the Parliament’s codecision procedure has been

extended and streamlined (Article 251 of the new version of the EC Treaty). Both of these may be deemed to have “added democratic value”.

57. In substance, however, nothing has changed in terms of the rather restricted functions of this sui generis Parliament. This is only logical, because the European Union is not conceived as a federal state. There is no European electorate. There are only the peoples of the member states, whose elected representatives convene in the European Parliament. Nor is there any European public opinion which might follow and monitor a Community-wide political decision-making process. The European Parliament therefore has no mandate to define the common European good. As in the past, the primary political responsibility lies with the member states and not at a distinct European level. That is likely to remain the case for a long time to come.

58. When monetary union begins, the Community’s monetary policy will be directed by the Council of the European Central Bank. The Council shall consist of the President, the Vice-President and four additional members of the Executive Board in charge of the bank’s business. In addition, the national central bank governors shall have a seat and a vote on the Central Bank Council. Since monetary union is beginning with 11 member states, the Central Bank Council will have 17 members. The size of this institution is roughly the same as the Bundesbank’s central bank council, and would be tolerable in functional terms. That is likely to remain the case if the other four member states join the single currency.

However, as the Community enlarges, further central bank governors from the new member states are likely to join in future. This could mean that the critical ceiling on the tolerable number of members is exceeded. It is therefore necessary to look ahead and examine what measures might be taken to restrict the number of members and thus ensure that the Central Bank Council can continue to function.

59. Whilst searching for potential solutions, it is worth looking across the Atlantic to the United States, which comprises more than 50 states. In order to restrict the number of members on the

### **The European Parliament**

### **The European Central Bank**

decision-making body of the US central bank (the Federal Open Market Committee), the number of state central banks is limited to twelve. This means that most state central banks are responsible for several states of the Union. Also, the voting rights of the governors are restricted in that only five of the twelve governors, together with six board members, including the President, are entitled to vote. The voting rights of the governors rotate every one or two years, depending on the size of their state central banks.

It is unlikely that the member states of the European Community will be prepared to reduce the number of central banks by merging them. Thought might therefore be given to introducing the rotation principle as soon as the new members from central and eastern Europe join the monetary union. It would seem sensible to have a solution whereby the governors of the large member states have an unrestricted voting right and the governors from smaller member states take turns at voting.

## **IV. Summary**

60. The enlargement of the European Union to the east is an extraordinarily significant project. Its preparation and successful implementation will, over the next 10 to 20 years, confront the Community with challenges on pretty much the same scale as those posed by the European monetary union project. Once again, Europe will be able and will have to prove that it is capable of institutional change and is not paralysed by sclerosis.

61. Neither the candidates for accession, nor the existing members, nor the Union as such are ready for the project. This is true both of the institutional changes which are necessary before any accession treaties can be signed and of the economic changes needed. But this

does not render the project unrealistic.

62. It is perhaps with regard to the institutional reforms of the European Union, which are unavoidable if eastern enlargement is to take place, that one should be least pessimistic. In principle, there are potential solutions which ought to be capable of consensus, once the desire to take the plunge and realise the project is present on all sides. In Amsterdam, however, this was not yet the case. And one cannot claim at present that the eastern enlargement project has stimulated a desire for further-reaching integration on the part of the Community. When the project is implemented, the nature of the European Community is likely to change, whether the Community wants it to or not. The principle of variable geometry introduced for the first time in Amsterdam could determine the structures of the future. As the “European house” expands, it will no longer be the case that identical rules apply everywhere. The traditional, highly ambitious concept of the constitutional community will be differentiated. New forms of cooperation may develop. This may enable European integration, a success story of this century, to remain adaptable in the face of the unknown challenges of the next.

63. With regard to the Community’s main fields of activity, i.e. agricultural and structural policy, it is chiefly important to arrive at the fundamental understanding that what previously appeared possible will no longer be possible in future. Since de facto both fields are dominated by interests in the redistribution of wealth, this would seem to be infinitely difficult. But, in objective terms, the transfers involved here are not necessary.

In the case of agricultural policy, the situation can and must be helped by the fact that, even without eastern enlargement, it will be impossible to continue the present policy. Also, it may be that the changes which appear unavoidable due to world-wide agreements to restrict protectionism in agriculture – as the World Trade Organisation develops – are not far removed from the minimum changes required by eastern enlargement. Conceptually, albeit insufficiently, the Community has already moved in the right direction. The same goes for Agenda 2000. In it, the European

Commission recommends a continuation of the 1992 reform by moving further away from the price support policy and closer to direct payments to the farmers. However, all of this is still a long way from the action needed for a fundamental reform of agricultural policy.

64. In the case of structural and regional policy, which is implemented via the Structural Funds and the Cohesion Fund, the Community has, by committing itself to strengthening its economic and social cohesion (Article 158 of the new version of the EC Treaty), given itself a job which creates nothing but problems. Since it is basically a question of redistributing wealth, it appears confusing enough. But it legitimises permanent arguments about redistribution and creates a pretty facade for even the most vulgar forms of vote-buying and horse-trading by pretending that they are about lofty aims of Community solidarity. The lack of available government funding must help to promote a more restrictive interpretation in future. In a substantially enlarged Community, anything other than a restrictive interpretation will in any case prove to be totally illusory. In ordo-liberal terms, there never has been a need for the Community activities financed by the Structural Funds and the Cohesion Fund. And there can be no question of the Community developing into a Union of transfers with substantial entitlements to fiscal equalisation. The establishment of European monetary union give renewed cause to make this clear.

In Germany, in their search for a noble justification for banal attempts to redistribute wealth in a federal state, many people have even interpreted – or rather invented – an obligation in the constitution for the state to ensure equal living standards throughout the country. In fact, the Basic Law contains no such thing; it merely authorises the Federal Government to act towards this objective and contains an obligation for the state, when dealing with a very specific task, i.e. distributing tax revenues between the Federation and the Länder, to work inter alia from the principle that “uniformity of living standards in the federal territory [be] ensured”. This is indeed more than the EC Treaty stipulates for European level, but it is by no means a commandment to create equal living standards. The problems deriving from German reunification have now prompted a corresponding change in attitudes. People are increasingly



understanding that, in reality, not even a federal state can make the equalisation of living standards a state obligation to a more than very partial extent, and that the alleged requirement to do this contained in the Basic Law is nothing more than the invention of wily interpreters. Geographical differences in living standards are natural and inevitable.

65. In Germany in particular, the need to save a lot of money not only in agricultural policy but also in the current system of structural policy (which is primarily regional policy) is seen against the background of a feeling in the country that it is already unable to cope with the high net contributions it has to make to the Community. Complaints about the high net German contributions should actually be addressed in a different way than is usually the case, if such complaints are to fit in with the nature of the Community. Defining shares of a sum of accounts, in this case the sum of so-called net contributions, does not make sense even in methodological terms. The Community does not receive a sum of net contributions, but a sum of revenues. And it does not make a sum of net payments (to the member states), but has a sum of expenditures. It is possible to define national shares of each of those. But it then becomes clear that the German share of the payments received by Brussels cannot, rationally, simply be termed inappropriately high. It roughly corresponds to the ratio of Germany's gross domestic product to the Community's gross domestic product. The greatly disproportionate level of German net contributions is solely related to the fact that Germany has relatively few entitlements to payments from Brussels or does not fully utilise its entitlements. In other words, the tasks of the Community, which were adopted jointly, refer to problems which are clearly underrepresented in Germany. Therefore anyone wishing to alter Germany's position as net contributor logically needs to tackle the decisions referring to expenditure, i.e. the definition of the tasks of the Community. Only if this approach cannot be taken or is not wanted by the others does it seem appropriate to desire a direct limit on the contributions by member states. This would only be a makeshift solution, although it would not necessarily be inappropriate. After all, there may be objective reasons, such as competition policy, why it makes sense to pursue a task, such as aspects of structural policy, largely at a Community level, even if no consensus can be reached on funding based on full solidarity. It is then necessary somehow to prevent those member

states which benefit little from the Community activity from fully sharing the financial burden. From 1980, this was the rationale behind the decision to relieve Britain of a part of its normal contributions to the Community budget.

66. For the Structural Funds, a renewed reformulation of the support objectives is at the heart of the reform of the definition of Community tasks as proposed in Agenda 2000. The number of objectives is to be reduced from seven to three, with two of them oriented towards regional policy and one focused on training and the labour market. In the course of restructuring, the proportion of structural funding going to Community initiatives is to be substantially reduced. Apart from that, however, the concept will remain unchanged. According to the Commission's ideas, the Cohesion Fund is also to be retained in its current form.

The approach taken – to redefine and to streamline the objectives of the Structural Funds – points in the right direction. This is particularly true of the intention to focus more on support for formation of human capital. However, since the underlying support concept is unchanged, this does not answer the funding questions posed by an eastern enlargement of the Union. Restricting the timeframe to the 2000-2006 period, as is done in Agenda 2000, creates a temptation to succumb to illusions. This may help to get the eastern enlargement project up and running in the first place, and stop people becoming discouraged and giving up in the face of the enormity of the task. But it is not a credible approach. In particular, it is totally unacceptable that, given the fact that current planning takes very little account of the tasks created by eastern enlargement, the Structural and Cohesion Funds are allocated not less money but – at ECU 275 billion for the 2000-2006 period – substantially more than for the 1993-1999 programming period (ECU 200 billion). This does imply (in real terms) a slight cut in existing entitlements, but is certainly no expression of a genuinely fresh attitude.

67. Going beyond Agenda 2000's cautious attempts at reform, deep-reaching changes in structural and regional policy should be introduced as early as the next programming period. Germany should be actively involved in this.

- The work of the Cohesion Fund is over. The current time limit on funding availability should be retained. In place of the Cohesion Fund, there could be an integration fund (also limited in time), solely aimed to help the acceding countries prepare for the competitive situation in the European Union.
- The Community initiatives should not be continued, but should be replaced by a small contingency fund for unforeseen emergencies and made part of the general Structural Funds. The limited tasks proposed at present (cross-border transnational and interregional cooperation, rural development, human resources in the context of equal opportunities) should be left to the member states or similarly integrated into the general funds and thus subjected to the control of the Council of Ministers.
- The overall framework for the Structural Funds should be tightened up. Funding amounting to 0.46 % of the gross domestic product is too high. The idea of using support programmes to mobilise potential for growth in the regions and to accelerate economic development in regions with a low per-capita gross domestic product has not really proved workable. The concept of growth stimulation has increasingly been displaced by a political battle to redistribute funding, and this is at least partially due to the fact that neither the potential for growth nor the impact of the support on economic development can be clearly defined. Instead of including areas covering over 50 % of the population of the European Union in structural and regional support schemes, it would be better to give the member states greater responsibility and to rely more on competition between the regions. The Commission's proposal that no more than 35 to 40 % of the population should be covered is still not ambitious enough.
- The Structural Funds should be merged, substantially simplified and focused more on cross-border measures. These include an expansion of trans-European infrastructure networks, as long as this is not misused as a make-work scheme but adheres to cost-benefit criteria. In addition, the European Union will have to respond to hardship cases and help where there are severe imbalances. Since, according to the principle of subsidiarity, it is primarily up to the member states to act themselves, it is worthwhile restricting the support, e.g. to regions which fulfil a

twofold criterion, i.e. that they are in member states whose per-capita gross domestic product is less than 90 % of the Union average, and that they themselves fall more than 30 or even 35 % below this average. These criteria could be supplemented by the requirement that the unemployment rate be more than 50 % above the European average, that the support funding amount to no more than 3 % of the regional gross domestic product, and that the member state provide at least 40 % of the funding. All support measures should be subject to a time limit.

- Instead of including the central and eastern European countries in the existing support frameworks, it would appear sensible to give them help to prepare for accession as planned, and then to continue this support in the form of the above-mentioned integration fund for a few years after accession. This would allow the particular transitional problems of the individual new members to be addressed.

68. In its Agenda 2000, the European Commission is aiming to outline “the broad perspectives for the development of the Union and its policies beyond the turn of the century, the horizontal issues related to enlargement, and the future financial framework beyond 2000 taking account of the prospect of an enlarged Union”. In the light of this objective and of the scale of the need for reform, Agenda 2000 fails by a long chalk to meet the expectations.

The Commission's criteria for accession are tailored to the continuing development of the existing Union structures. For example, it measures readiness for accession against more than just the yardstick of whether functioning market economies have been established in the relevant countries. The criteria stretch far beyond this. In addition to economic criteria, political criteria and “other commitments of the member states” must be fulfilled. The latter include the acceptance of the aims of political union and of economic and monetary union. Also, the *acquis communautaire* must be taken on board. In principle, however, the basic elements of a market system are reflected in the Commission's accession criteria.

Regarding the results of the assessment, all the countries are deemed to fulfil the political criteria. They are described as democracies with stable institutions, the rule of law, preservation of

human rights and respect and protection for minorities. This is correct. The Commission also correctly highlights the weaknesses in law enforcement in the countries in transition. However, the five countries are described relatively broadly as functioning market economies, and (with certain reservations about Estonia) it is considered likely that they will be able to survive in the medium term in the face of competitive pressures and market forces within the Union. Taking this view, the necessary structural change in the countries in transition appears to be a less serious problem.

This creates the impression that the economic reforms already completed or introduced and the related structural change create few doubts within the Commission about the readiness of the countries in transition to join the Community. The real problems which diminish the countries' suitability to join are believed to lie primarily in the acceptance and implementation of the *acquis*. The Commission is mainly interested in a harmonisation of national law with the highly complex Community law, something that confronts even the highly developed bureaucracies of the existing members with a supreme challenge.

69. Rigorous harmonisation of laws cannot be in the interest of the five candidates for accession. It is true that the need for harmonisation may mean that resistance to reform in areas like financial services or network services (e.g. telecommunications) is overcome. However, harmonising the laws may also impede the development of the emerging market economies. The question arises as to whether the attempt to take on the *acquis* at an early stage might not result in unreasonably high costs in the countries in transition. One could almost imagine that the European Union is not really interested in a rapid enlargement to the east. After all, requiring this sort of harmonisation would indeed be an effective way to stretch the accession process over the longest possible period.

70. One of the fundamental freedoms which has been part of the European Community from the very beginning – i.e. freedom of movement for workers – causes a lot of worry to many people when they think of the eastern enlargement project. That is understandable, because the temporarily massive differences between the economic strengths of the old and new member states may result in major migratory flows. In the countries most affected, such move-

ments would be experienced as a threat to job and income opportunities. The only way to allay these concerns is to impose abnormally long transition periods before full freedom of movement is achieved.

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