**The Negotiating Position of the European Union on Agriculture, the Structural Funds and the EU Budget**

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# Abstract

The negotiations for the accession of eight of the central European candidate countries and Cyprus and Malta to the European Union are reaching the final stage. The core problems of this negotiation, agriculture, the structural funds and the budget, have been clear for some time and were purposely left until the end. But now they have to be tackled.

The conclusion of this major enlargement process is occurring at a difficult phase in the development of the Union. Key policy areas like the Common Agricultural Policy and the Structural Funds are likely to undergo serious reform in the coming years. Other policy areas are developing rapidly and the impact of EMU on fiscal policy coordination is not clear. At the same time the slowing of economic growth, the lack of reform in some markets and the impact of the Stability and Growth Pact have made existing member states very prudent in their financial offer to the candidate countries.

The first clear indication of possible EU positions on these negotiating subjects has come in the publication of issues papers by the European Commission, prior to the determination of the Common Opinions of the Member States. The objective of this working paper is to analyse these ‘proposals’ and to indicate a possible response of the candidate countries to them.

For the candidate countries, the issues of equality of treatment and no distinction between old and new members of the Union are at least as important as the level of transfers they will receive. With the need to win referenda on accession, they cannot afford to agree to a clearly unfair settlement with the Union. The ‘proposal’ advanced by the Commission does not seem particularly equitable and should be improved if referenda are to be won.

However more important is that the Commission is suggesting that decisions on the coming financial framework 2007-2013 should be made prior to accession, which would limit the scope for the new Member States to affect the decision on the financing of the Union and would be the final proof that they are second-class member states.

## Introduction

The negotiations for accession to the European Union of the first ten candidate countries from central and eastern Europe, Cyprus and Malta, are reaching their final stage. Many individual, specific, bilateral problems remain but these are being negotiated away rather efficiently under the Spanish Presidency of the Union. One can certainly expect the Danish Presidency to continue this progress in order to meet the objective of finishing the negotiations by the Copenhagen European Council at the end of 2002.

The negotiations have now reached the key 'end-game' chapters which are horizontal in nature. It was always certain that the problems of agriculture and the EU budget were going to be the most difficult negotiating problems to solve. They have of course become more difficult as the world economic slowdown has progressed and government deficits have begun to build throughout the continent.

It is of course not yet clear what the EU Common Position in these areas will be; this we will only see in the coming weeks. What we have to go on is the evidence of the Berlin Financial Framework, the discussion papers of the Commission, produced at the end of January 2002, and the comments made by the different member states since those papers were published.[1] [2]

One key fact is already clear:

- The Berlin financial framework cannot be changed in a way that would require unanimity in the Council and a passage through the Parliament.

The question of flexibility within the Berlin framework should however be investigated

The key question for the candidate countries and for the future of the European Union is whether what will be proposed will constitute a different quality of membership of the Union to that enjoyed by the 'fifteen'. This is particularly important for countries which are coming from a system where there was clear inequality between the satellites and the centre or where they were an integral part of the Soviet Union. But it is also important for the whole Union, in that it would be the first time that an accession had taken place in such conditions and this might set a precedent for future enlargements and indeed for changes in the way the Union itself is governed.

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[1] Mayhew A. (2000), Financial and budgetary implications of the accession of central and east European countries to the European Union, SEI Working Papers in Contemporary European Studies, No. 33.

[2] European Commission (January 2002),
SEC(2002) 102 Information Note Common Financial Framework 2004-2006 for the Accession Negotiations, and
SEC(2002) 95 Enlargement and Agriculture: Successfully integrating the new Member States into the CAP; Issues paper

This paper is divided into six sections:

1. a brief presentation of the Commission proposals together with an assessment of possible differences with the final common position of the Member States
2. an analysis of the Commission proposals,
3. an analysis of the reasons behind the position taken by the Member States
4. the implications for the Financial Framework 2007-2013
5. an analysis of the financial impact of the Commission proposals on the candidate countries
6. a suggestion for a negotiating position of the candidate countries.

## 1. A brief presentation of the Commission proposals together with an assessment of possible differences with the final common position of the Member States

The Commission 'proposals' are not formal proposals but ideas put forward in the Commission's 'issues' papers, produced at the end of January 2002. They must first be turned into 'draft common positions' on agriculture and the budget, and then after discussion between the member states into 'common positions'. These common positions of the EU-15 should be ready in late Spring 2002. The Commission's ideas are however formulated with such attention to detail, that it can be assumed its final proposals to the member states will not be very different from the ideas expressed in the issues papers.

### A. Agriculture

It must be remembered that there are three main problems in the negotiations of the agriculture chapter: the issue of direct income subsidies, that of reference levels for quotas and other CAP mechanisms and veterinary and phyto-sanitary issues. The latter question, which is largely a technical one, is unlikely to create major political problems though solutions to the technical problems may be difficult to find.

Each candidate country has a number of particular national negotiating issues, which are not shared by other candidate countries. These are considered to be of minor importance. One general point however unites many of these particular national requests. The answer of the Union has often been to say that the problems will be resolved after accession in the management committee procedure. This solution clearly leaves the candidate countries vulnerable to being outvoted in the management committee. It would therefore appear more sensible to clear up some of the most important questions before accession during the negotiations on the agriculture chapter. However as none of the candidate countries appears to have raised this question as a problem in the negotiations, it will not be dealt with further in this paper.

The Commission suggests that the negotiating position of the Union should be:

- Negotiations take place on the basis of the current acquis and should not affect or be affected by the discussion on future reform of the CAP
- Direct income subsidies for farmers in candidate countries should be phased in over a 10 year period, starting at 25% of those paid in the existing Union in the first year of accession
- A scheme of flat-rate payments for a group of self-subsistence farms should be introduced
- Somewhat more money should be made available for rural development measures in the new Member States than suggested in the Berlin Financial Framework to take account of a larger number of accession countries
- Reference levels should be set to reflect actual production in a recent year, 1995-1999
- National aids, existing before accession, can be registered with the Commission and continue to be paid after accession, on the condition that they conform to EU rules on national aids in the CAP
- The Commission provides detailed proposals on production in all the sectors with a market organization, relevant for the candidate countries. These proposals have to be evaluated in detail by the candidate countries individually. They appear to suggest a reduction in the levels of output requested by the candidate countries as reference levels, although this is not the case for all products.

The main arguments of the Commission on the subject of direct payments are that it is trying to protect the candidate countries from a development which would have negative long-term impacts on agricultural structures and the economy and that the Union cannot afford to pay more. As to reference levels the Commission maintains that reference levels have to apply to a recent year of actual production and cannot take account of estimates of potential output.

It is unlikely that the common position of the Union will differ fundamentally from the position taken by the Commission, as long as the latter can demonstrate convincingly that its proposals are consistent with the Berlin financial framework. Certain member states consider that the Commission has been too generous in its 'issues' papers, but it is unlikely that they will go as far as trying to reduce the levels of direct payments suggested by the Commission. Some may consider however that to project payments into the next financing period breaks the rule of these proposals being reform-neutral.

## B. The structural funds

The Commission does not deal separately with the structural funds; they are realistically incorporated in the budget paper.[3]

[3] Structural fund payments are fundamentally transfer payments with little essential policy content, though this may change in the future.

The key principles on which the Commission has worked are those laid down in the Berlin European Council:

- The overall limit of structural funds spending to 2006 is laid down in the Berlin financial framework
- In future no Member State shall receive more than 4% of its GDP from the structural funds in any year
- While in terms of both payments and commitments the Commission considers that absorption will be limited in the period up to 2006, there is no indication that it wishes to treat the new Member States differently from the EU-15
- The Commission proposes to increase the proportion of the structural funds which can be used as Cohesion Funds to one third

The Commission papers, correctly, do not deal with the period after 2006. They therefore do not consider the discussion about the criteria for receipt of structural funds after enlargement. This discussion is of direct interest to most of the candidates in that the outcome of the discussion will determine the overall level of structural funds available to the candidate countries after 2007. Certain areas of the new Member States may even exceed 75% of average EU GDP per capita (at purchasing power parities) if a strict interpretation of this limit is adopted after enlargement (Prague region and Slovenia).

While not suggesting that there should be a transition period for entry into the structural funds, the Commission does put an upper limit on transfers to the new member states for the period from 2004 to 2006. It is expected that absorption will be slow in the first years; transfers are then expected to be of the order of 1.95% of GDP in 2004, 2.2% in 2005 and 2.7% in 2006, assuming GDP in real terms in the candidate countries grows at an average annual rate of 3% from 1999 to 2006.

**C. The EU Budget**

On the revenue side of the EU budget (own resources), the Commission assumes that the new Member States will contribute fully to the Own Resources of the Union from accession.

On the expenditure side, most of the budgetary detail comes automatically from the consideration of agriculture and the structural funds (together 80% of the EU budget). The Commission explains that it has to stay within the limits of the Berlin Financial Framework, corrected for the increase in the number of countries joining the Union (10 rather than 6 as assumed at Berlin) and the date of enlargement (2004 instead of 2002 assumed at Berlin). Having stated this however, it does not use the additional flexibility, staying below the Berlin Financial Framework for commitment appropriations and well below for payments appropriations. The explanation is that the proposal is a compromise between the minimalist proposal of taking the first three years of the Berlin Framework (2002-2004) as the amounts for the first three years of actual membership (2004-2006) and the maximalist one of simply transcribing the amounts for 2004-2006 from the Berlin Framework to the new modified framework.

There are however several other points worth noting in the new Commission proposal:

- Amounts are set aside for the decommissioning of Ignalina and Bohunice nuclear reactors and for support to Northern Cyprus
- A transitional facility for institution-building is proposed until 2006
- A budgetary compensation reserve is created which should mean that ‘no new Member State should find itself in a net budgetary position which is worse than the year before enlargement’. Lump sum payments will be available up to a total amount of approximately EUR 800 million each year for 2004-2006, the funds only being released if needed to achieve this aim.

It is worth noting that the Commission proposes some EUR 2.4 billion less in commitment appropriations and EUR 6.5 billion less in payments appropriations than contained in the Berlin Framework for the years 2004-2006, if one ignores the proposed compensation payments.

## 2. An analysis of the Commission proposals

The ***assessment of these proposals*** has to test them, amongst others, against the fundamental criteria of:

- Fairness
- Economic rationality
- Administrative practicality
- Political acceptability

### a. Agriculture

The **agricultural proposals with respect to direct income subsidies** are manifestly unfair. Farmers in the new member states will be receiving only 25% of the amount of state aid which farmers in the EU-15 are receiving. For the first time in the history of the EU, dumping will be taking place in the Union, inviting anti-subsidy measures to be taken. The introduction of a tariff barrier within the Union would however be disastrous and simply underline the fact that there is a two class Union. As these state aids are still linked to production, this means that farms in the EU-15 are also receiving more aid anyway because the average size of farm is larger than in the new member states.

The Commission argues that the proposals are **economically rational** because giving full state aids (direct payments) to farmers in the new member states will slow down the pace of structural reform, which is necessary for the long-term viability of agriculture in these countries. What is needed instead is more money for investment in rural development, creating alternative employment in the countryside.

There is a great deal of sense in this argument. Welfare payments should be limited in time and be degressive. They should allow people to adjust to changing circumstances but should not prevent this necessary change. In the context of economic rationality, it should be noted that the rate of restructuring in agriculture which is desirable will vary from country to country. It may be socially more desirable for this rate to be slower in areas where there are large numbers of small farmers and little alternative employment in rural areas and where there is already a high level of unemployment. It makes no sense however, not even from the point of view of social morality, to prevent restructuring taking place.

Putting money into rural development will help those people leaving farming to find employment without having to move to the towns and will further the objective of creating sustainable development in rural areas.

Unfortunately for the Commission the logic of this argument does not simply apply to the new member states and it must be consistent. Surely this same argument applies to farming in the EU-15 where structural and other reform is clearly necessary. But the Commission makes no recommendations about eliminating or even reducing these payments here. We have to wait for the mid-term review and the reform discussion around that.

It is also strange, if the Commission feels that these payments are so bad from an economic viewpoint, that it proposes that full levels of payment should be made also to farmers in the new member states by 2013. Why are payments bad now but good in 2013?

The final bizarre twist in the argument of the Commission is that it is quite happy to see EU direct payments topped up by national payments, as long as the total payments do not exceed those paid in the other EU member states. This suggests again that the Commission is not convinced by its own arguments of economic rationality.

It should also be remembered that direct income subsidies consist of many different schemes, regulated by different legal measures. Owing to their different character, it will not be possible to apply a simple regime of transition such as the Commission proposes. Instead a series of adjustments will have to be proposed. The question should also be put about direct payments systems to be introduced in the future. What justification can be made for a transition period in direct payments to compensate for milk quota abolition? The proposal in the Commission paper is yet another sign that the Union wants to determine the next financial framework before enlargement.

These deficiencies in the logic of the Commission's argument can only be explained as a political signal, given by the Commission to the member states, that many of the latter's positions are untenable.

In terms of the **administrative practicality** of the direct payments proposals, the Commission appears to be helpful in suggesting a simplification of the method of payment. This needs to be checked however in detail by each candidate country, because the Commission proposal may have disadvantages for certain of them. In general terms, it would seem better for those countries with a well-developed commercial agricultural sector to opt for the full implementation of the IACS system at accession: and this may apply to all the candidate countries.

In terms of **political acceptability,** the Commission proposals have met some opposition from the current member states, which consider that the Commission should not have proposed any level of direct payments. They argue that these were not included in the Berlin financial framework and were in fact expressly excluded. Nevertheless it is not to be anticipated that this resistance will be sufficient to seriously change the proposal of the Commission.

On the side of the candidate countries the proposal creates a serious problem for governments. The proposal to phase in direct income subsidies over a very long period merely serves to emphasise that the new member states will not be treated as equals for at least a decade. Some phasing in of subsidies could be accepted and might even be considered normal but this period should not stretch into the next financing period. This suggests that not only are the new member states being treated unfairly but that the EU-15 are determined to decide on the detail of the next financing framework before accession so that the new member states will not have a chance to influence the debate even when they are members. <u>This is perhaps the worst element of the proposals from the point of view of the accession countries and the most difficult to explain away to the electorate</u>

Most of the new member states will have to hold referenda as part of the pre-ratification procedure on the accession treaties. In the some of these states, even though the majority of the population lives in urban areas, their rural roots are only a generation away and solidarity with rural populations and farmers is still strong. If it is felt that farmers have been badly treated in the accession treaties, the results of the referenda may well be a rejection of the terms of accession.

Governments are caught between the absolute need for early accession and the unacceptability of the Union offer. This is the reason why the reaction of most governments has been very muted. They know that in the end they will have to accept part of the proposal of the Commission but hope that in the negotiations they can improve the offer sufficiently to persuade the majority of their citizens to vote for accession.

A particular novelty of the Commission proposals is the flat rate assistance to be given to **semi-subsistence farms** up to a maximum of EUR750 per farm per year. This would only go to farms which had a business plan charting their route to become commercial farms. The idea is interesting but at present too vague to comment on (how is a semi-subsistent farm defined? When does it stop being semi-subsistent and so on?)

The proposals regarding the **quantitative reference levels** for quotas and other management instruments are important for several reasons:

- The reference levels have the effect of freezing the pattern of agricultural production. They eliminate the normal competitive pressures which lead to specialization and which give room to more dynamic farmers to expand their production
- They have a clear impact on the payment of direct income subsidies, because these latter are still linked to production

Again this question must be addressed in detail because the situation is different from crop to crop and country to country. This is why the Commission has presented its proposals in a series of annexes devoted to individual products. Here however we can only discuss the general problem of the establishment of appropriate references.

Agricultural output at the end of the nineteen-eighties in the candidate countries was in general far higher than that today. The decline in agricultural output is the result of a mixture of factors, which vary from country to country but which generally have the following elements:

- The economic transition after 1989 led to a massive disruption in agriculture as the agricultural structures of communist regimes were broken up and often returned to private owners
- Agriculture was frequently neglected owing to the need to complete the transition in industry and the services as well as the political and social transition
- Domestic agricultural products were priced out of markets, domestic and foreign (for instance in Russia) by the heavily subsidized exports, including humanitarian assistance from the EU or the USA. Exports also suffered from the general economic crisis in Russia in the second half of the nineteen-nineties.
- Drought and other natural hazards have also taken a heavy toll of output

The result is that the candidate countries propose to take reference levels from the nineteen-eighties, while the EU insists on taking a recent production year.

Here probably both sides are right. Taking a reference year from the nineteen-eighties would be wrong because agricultural holdings were operating under a totally different economic system, with statistics which were often dubious and subject to strong political influence. In several countries, the ownership pattern has changed considerably since that period.

On the other hand it is clear that most candidate countries are working at levels of production well below potential. This is confirmed by most foreign investors in the food industry, who are in general interested in an expansion of agricultural output in the candidate countries to feed their new investments. They fear that low reference levels, especially of milk, will affect the viability of their operations.

The outcome of the negotiations cannot be predicted as they will have to be carried out product by product. It would however appear to be **unfair** to take particularly low output figures of recent years as reference levels.

A fairer and **economically more rational** approach would be to base output on a recent reference year but to negotiate an adjustment, product by product, to take account of the low level of production.

Economically however this question must be considered in the perspective of the WTO agricultural negotiations and the mid-term review of the CAP. The Commission is obviously worried about the implications of enlargement, and above all any increase in output following enlargement, for the current round of WTO agriculture negotiations. The Commission specifically states that its proposals are in line with the Community's negotiating proposals adopted by the Council of Ministers. There is a clear interest on the part of the Member States that any further reduction of output made necessary by the WTO negotiations should fall on the new Member States as well.

The choice of reference level also obviously makes a considerable difference to the level of agricultural support which the Union budget will have to bear after accession.

**Politically** in the accession countries, this question of reference levels is, at present at least, less of a problem than the question of direct income subsidies. It will become one however as the negotiations go on and as opponents of accession exploit every weakness in the application of the fairness principle. In a situation where deep and perhaps rapid restructuring is taking place, with a food industry which is expanding, Community quota and other regimes may well be seen as yet another way of restricting the development of agriculture in the new Member States. For the longer term, it is probably more important to get a satisfactory agreement on reference levels than on direct income subsidies to farmers.

**Rural development**

The proposals on rural development foresee a similar level of funding in real terms for the years 2004-2006 as suggested in the Berlin Financial Framework.

| In EUR million: 1999 prices | 2004 | 2005 | 2006 |
|---|---|---|---|
| Commitments | 1532 | 1674 | 1781 |
| Payments | 748 | 1187 | 1730 |

The Commission suggests one important improvement, namely that all rural development measures should be implemented as differentiated appropriations; in other words that moneys committed in one year do not all have to be paid in that year. This is particularly important as rural development measures are likely to be disbursed rather slowly. The Commission has made assumptions on disbursements leading to a three-year payments profile of 35%, 45% and 20% with an advance of 12.5% in the first year. This profile may be rather optimistic.

The Commission is certainly right to put the emphasis of policy on rural development, especially in those candidate countries, where restructuring is likely to be rapid in coming years. The only real long-term solution is the development of a strong competitive agriculture together with significant employment opportunities outside farming. This does not mean automatically the creation of larger commercial farms, but can be small specialist holdings producing organic crops or other high value added crops or part-time farms, where part of the family income is produced outside the farm. However people will in any case be released from farming and, if they are to stay in rural areas, alternative employment must be available.

Alternative employment will only be created if services and infra-structure (including roads, telecommunications, education, health services and others) in the countryside are improved. Other measures such as retirement schemes for farmers and the provision of risk capital and micro-lending will all play a part in the development of rural areas.

The emphasis which the Commission puts on using the structures established by the SAPARD Programme makes good sense. The commitments available, according to the proposal of the Commission, will be between twice and three times the level of funding of SAPARD over the period 2004-2006. Absorption will be a problem in the early years. The new Member States need to evaluate their experience with SAPARD to establish which rural development measures are the ones which are most useful in the longer-term and which are the ones which give rise to rapid absorption of the available funds. Pensions for early-retiring farmers may be an important longer-term measure to allow the consolidation of farms into more competitive units. It is therefore vital that preparation for such a scheme is started. However such schemes are often difficult and long to develop. In this case candidate countries need at the same time to have other fast disbursing measures ready to absorb funds in the first few years of membership.

### b. The Structural Funds

In general terms the Commission proposals for the period 2004-2006 should not pose any real constraint on spending by the candidate countries. In the short-term the proposal to spend more of the available finance through cohesion funds is indeed very helpful because it tackles the twin problems of the candidate countries – potentially low absorption rates and the availability of budgetary cofinancing funds. The proposal is in general **fair** and **economically rational** in the short-term, In the longer term, when absorption rates have risen, the Union proposal may have drawbacks for the candidates.

In terms of **administrative practicability**, absorbing structural funds is not easy, especially in the first two years of a programming period. Even the EU-15 countries absorb very low amounts of funds in the first year of multi-annual programmes. For some of the new member states it is not even sure that all of the procedures to start their three-year programmes (2004-2006) will have been completed by accession. Absorption of these funds may well peak in 2006-2007.

The Cohesion Funds operations consist however of much more straightforward project financing. The new Member States have the time to thoroughly prepare individual projects for financing from the Cohesion Fund before accession. Absorption could then begin rapidly after January 1st 2004. The availability of enhanced cohesion fund spending is therefore an important advantage of the Commission proposal.

The level of cofunding and the availability of government budgetary resources will also be a critical limiting factor on absorption. Many of the new candidate countries are engaged in budgetary consolidation (partly with a view to the Maastricht criteria) while social needs are large not to mention the burden on the budget of meeting the terms of the Accession Treaty in areas like the environment. Here again the increased allocation of structural assistance as Cohesion Funds will somewhat lessen the burden.

Even with this additional facility, most experts would consider it unlikely that the new member states will absorb the payments appropriations available in the Commission's revised Berlin financial framework.

In the longer term, the absorption capacity of the new member states will increase. At this stage the regressiveness of the rule that no country can receive more than 4% of its GDP (at current prices and exchange rates) will begin to be a handicap, especially to those countries which can use the funds wisely. This rule favours richer poor regions over poorer poor regions. The Commission points out that in terms of per capita receipts, the new member states will be receiving EUR 137 against EUR 231 in the four cohesion countries in the period 2004-2006, even though this represents a lower proportion of GDP in the latter.

Given the level of need for investment in infra-structure of all types in the candidate countries, it would seem reasonable to make the 4% of GDP limit more flexible after 2006. Those countries which are able to absorb higher levels of structural funds and which comply with macro-economic conditionality established by the Union should be able to exceed the 4% limit.

Because the proposals of the Commission, at least in the short-term, appear balanced and fair, they have not provoked any real **political** debate either in the candidate countries or the existing member states.

## c. The Budget

In terms of **fairness** and justice, the proposals of the Commission, which are likely to be mirrored by the Common Position of the Member States, fail almost every possible test. The GDP/capita of the 10 first round accession countries is around EUR 4550 measured at current exchange rates and prices and around EUR10150 at purchasing power standards.[4] These figures represent respectively 21% and 45% of the average for the EU-15. On the basis of the current application of EU policies, notably the CAP and structural funds, the new member states would clearly be significant net recipients of funds. Instead it is certain that on the proposals contained in the Commission issues paper, the new member states can only, at best, have roughly the same level of net receipts in the first year of membership as in the last pre-accession year. The probability is indeed that some of them will be net contributors to the EU budget in the first year of membership and perhaps in the second year too.

The Commission states in its paper that none of the new member states should have an EU budget balance which is worse in 2004 than in 2003. But its own figures demonstrate that this is the best case scenario. In 2003 the 10 candidate countries will receive a net revenue from the pre-accession funds of approximately EUR 2 billion (payments appropriations). In 2004 they will be asked to contribute fully to the EU budget; this involves a collective payment of around EUR 5.3 billion. In order to be in the same net position as in 2003, they would have to receive payments of EUR 7.3 billion. However the Commission only allocates EUR 5.7 billion payments appropriations for 2004 together with the remaining payments from the pre-accession funds, which will have stopped committing resources in 2003 (again approximately EUR 2 billion or slightly less). The result is that globally the ten new member states are likely only to be just better off in net terms in 2004 than in 2003: and this calculation supposes a complete disbursement of the lump sum compensation payments mentioned by the Commission. This certainly means that for some new member states there will be a decrease in the net position from 2003 to 2004.

However while the Commission has set EUR 5.7 billion aside for payments in 2004, it is clearly unlikely that new member states will be able to absorb this amount in the first year of their accession. It is therefore most unlikely that all of these payments appropriations can be used in that year. An undershoot of at least EUR 1 billion is likely, meaning that the new member states would be worse off in net terms than in 2003.

If the likely net position of the new member states is calculated with any degree of care, several of them will be net contributors to the EU budget in their first year of membership. This results from the fact that on the expenditure side of the EU budget, payments to the new member states consist of

- Low levels of agricultural subsidies, some of which will not be paid until the second year of membership (direct income payments)

[4] EUROSTAT, February 2002

- rural development funds, which will be difficult to disburse quickly
- structural fund payments (including the Cohesion Fund) which will also be absorbed slowly
- the new member states will be underrepresented in expenditure for internal policies and administration, with the exception of Lithuania and Cyprus, which will receive specific tied assistance as mentioned above

But on the resources side of the EU budget the new member states will pay:

- full contributions to 'Own Resources' to be paid from the date of accession

The new member states are being treated on the revenue side of the budget as full member states from the date of accession but as 'detached' member states on the expenditure side.

To meet the criterion of fairness and justice, it would be necessary to introduce a transition period for contributions to match the transition periods proposed for payments to the new member states. This would not however undo the damage done by the proposals for a ten year period of discrimination in state aids in agriculture.

In addition to the proposals on own resources contributions, the Commission's budgetary issues paper also proposes that approximately EUR 100 million should be made available annually from 2004-2006 for the decommissioning of the Ignalina and Bohunice nuclear power plants. The majority of these funds will go to Lithuania. It is unclear to what extent these amounts will finance the work required. A further EUR 200 million will be made available over the three year period, 2004-2006, for the economic development of northern Cyprus.

The final two elements in the proposed budgetary chapter are lump-sum compensation payments and a transition facility for institution building. The lump sum compensation payments use the margin between the commitment appropriations proposed by the Commission in its issues paper and those agreed in the Berlin Financial Framework. The Commission prefers for technical reasons that any compensation payments to the new member states should be made on the expenditure side of the EU budget rather than through a reduction of contributions to own resources. This margin could obviously be used for other purposes than compensation payments (see below).

The transition facility for institution building appears to be a way of phasing out slowly the twinning scheme, which has been running, with very mixed success, in the pre-accession period. As this programme will be 'decided by the time of the accession treaty' it is clear that the Commission wants to be able to decide about the use of these resources before accession. The new member states can perhaps try to exert some greater control over the choice of projects to avoid further waste of resources and should refuse any request for co-financing.

In terms of **economic rationality** the Commission's budget proposals are somewhat difficult to understand. Clearly there is a desire from the existing member states to reduce their net transfers to Brussels or to maintain their net receipts from the Union.

However the net benefit to the EU-15 from integration with the central and eastern European candidate countries has led to large economic gains, especially for those EU member states closest to central Europe. These gains will continue, as long as economic growth is far higher in the new member states than in the old. Matched against these gains is the relatively small budgetary cost of 'doing enlargement properly'.

The political and economic damage of creating an internal market in which for a decade dumping will be taking place because of differential state subsidies and where a budgetary settlement has been imposed in which poorer old member states with 80% of the per capita GDP of the Union receive larger amounts of net funding from the Union than new member states with only 45% of the per capita GDP of the Union will be considerable.

It should also be expected that in relatively poor but rapidly developing new member states, where capital is rare, the return on investment would be higher than in the old member states. It would therefore make economic sense for the EU-15 to be interested in the rapid development of these economies, in which development, the old member states would have a significant share.

At a more detailed level, technical payments procedures will lead certain of the new member states into considerable budget difficulties, at least in the early part of their membership (see below).

Finally it should be noted that all of the budget calculations are in EURO at 1999 prices. By the date of accession, accession currencies may have moved against the EURO. Exchange rate variations may have a considerable impact on the net budget positions – a devaluation against the EURO would improve the position in national currency on both the contributions and receipts sides while a revaluation would give the opposite effect.

In terms of **political acceptability** the proposals are difficult for candidate country governments to accept. As they fail on the test of fairness, they will make the task of winning referenda more difficult.

In summary the Commission proposals pose the following main problems for the candidate countries:

- they make clear that the candidate countries will be treated unequally for at least a decade after membership
- they suggest that, even as full member states, the candidates will not be able to freely participate in the decisions on the next financial framework (2007-2013), because essential elements will be established in the accession negotiations

- the proposal that the new member states should contribute in full to own resources, while having formally established transition periods on the receipts side of the budget, is impossible to justify on any basis.

## 3. An analysis of the reasons behind the position taken by the Commission and the Member States

The positions taken by the Commission probably reflect closely the opinions of the governments of the Member States. There are two areas where there may be some doubt, as mentioned above:

- Whether the Member States will want to say anything about the post – 2006 period
- Whether some member states will want to eliminate any mention of direct income subsidies for farmers in the new Member States.

It is interesting to note that the estimates of the net cost of enlargement to the EU-15 have fallen dramatically over the last decade. Early estimates suggested that enlargement could cost EUR 40 billion per year for agriculture alone.[5] The Commission paper to the Madrid European Council in 1995 suggested a cost of around EUR 12 billion for agriculture alone after the first years of membership.[6] Today the Commission estimates the net cost of the accession of ten countries at only approximately EUR 2 billion in 2004 rising to EUR 7 billion in 2006 (payments appropriations).

The reduction in the net costs for the EU-15 has been achieved by capping both agricultural and structural funds spending to the new Member States, while maintaining full contribution levels.

This attitude of the member states can be explained by three elements, amongst others:

- Monetary Union and the Stability Pact
- The need to reform certain EU policies, a reform which has been delayed for too long
- The diverse interests of the EU-15 in the enlargement

Monetary Union and the accompanying Stability Pact have forced the Member States to pay considerable attention to the level of the Government deficit. This has recently been

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[5] Anderson, K. and Tyers, R. (1995). ‘Implications of the EC expansion for European agricultural policies, trade and welfare’, in R. Baldwin et al., Expanding membership of the EU (Cambridge: Cambridge University Press)

[6] European Commission (1995) The ‘Fischler’ Report to the Madrid European Council (Brussels)

seen in the discussions on German and Portuguese fiscal policy and the possible sending of a warning to these governments. The Stability Pact operates in recessions as well as in upswings. As the economic weakening has hit member state governments, both tax revenues have declined and expenditure has increased, leading to rising government deficits. With the need to cut expenditure in the recession, any transfer to Brussels has to be met by a cut in expenditure at home. The situation is perhaps at its most extreme in Germany, where in addition to the impact of the economic downswing, a tax reform has led to dramatic cuts in revenue for local authorities, which are forced to reduce considerably the level of spending on local services.

Of course the fiscal policy challenges of the member states are explained also by the lack of reform in domestic policies, notably labour market and social policies, leading to high expenditures. These reforms may well be accelerated by the current crisis, but the fruits of reform will not affect the present financial negotiations for accession.

Most of the EU Member States would like to see some reform of the CAP and of the structural funds. There is however no agreement on the content of these reforms. This lack of clarity on the reforms is one of the biggest problems for the negotiations with the candidate countries. Logically the reforms would be discussed at the same time as the negotiations and with the participation of the candidate countries. However the timing and the political interests of the EU-15 will not allow this. **To wait for the reforms to be decided, as the Dutch and Swedish Governments have proposed, before completing the accession negotiations would lead to a considerable delay in enlargement, which is in nobody's interest.**

Two elements in the reform are very important for the future of the new Member States in the EU. The first is the future of direct income subsidies in farming, the second the way of dealing with those regions in the existing member states which benefit from structural assistance today but may not after the enlargement. **If, for instance, it was certain that direct income subsidies would become degressive and be phased out, it would be not unfair and economically sensible not to introduce the system to the new member states.** If there was clarity on the future of structural funds financing, the negotiations would also be easier.

However this problem will not be resolved and the negotiations for accession will have to proceed without the outcome of the reform discussions being known.

The fact that the Member States have very diverse interests in the questions of enlargement and reform of Community policies is well known. It creates complications as different Member States attempt to persuade the candidate countries to support their particular policies. The conflicts need not be explained further here; it suffices to refer the reader to the Italian and German papers on the reform of the CAP which have been submitted to the Council of Ministers.

The pressures on the Member States from these various factors are unlikely to diminish in the course of the coming negotiations. Therefore in designing a strategy for completing the negotiations, the candidate countries need on the one hand to understand the realities of the situations in the different member states (including the schedule of elections) and on the other to set clear priorities in their negotiating objectives.

## 4. Reform of EU policies and the implications for the Financial Framework 2007-2013

The normal procedure in the Union to establish a financial framework for the period after 2006 would be for the European Commission to make a proposal at the end of 2004 or in early 2005 and for the European Council to decide on the final form in 2006. This procedure, if combined with respect for the enlargement timetable, would mean that the new member states would play a full part in the decisions on the future financial framework. This would also be a clear sign that they are full and equal members of the Union.

The implications of the Commission's proposal for this procedure have been discussed above. An analysis of the statements made by the Member States in the preparation of the discussions for policy reform and the budgetary negotiations can also give us a good idea of the core problems which the Union will face in the next three or four years.

Perhaps the most difficult factor in the negotiations is that it is impossible to predict the outcome of the discussions on the reform of the Common Agricultural Policy, the Structural Funds and the EU Budget, but these outcomes will affect the financial framework beyond 2006.

On the reform of the Common Agricultural Policy there are now several countries, which are in favour of deep reform. To this group belong the Netherlands, the United Kingdom, Germany and Sweden, and possibly some others. It seems ever more likely that the European Commission may well join the reformers.

These countries all want to see a phasing out of the system of direct income subsidies. The argument is quite straightforward. The payments were introduced in the early nineties as compensation payments for the lower prices, resulting from the McSharry reforms. They were intended to allow farmers to adjust to the new situation. They have now lost any justification as compensatory payments and the fact the Swedish, Finnish and Austrian farmers also receive them simply underlines this fact.

They further argue that direct income subsidies distort agriculture, leading to inefficiency and slow restructuring. They therefore do not help agriculture to become more efficient and competitive on a world scale and waste public resources, which could be better used elsewhere. The Union will have to run them down anyway in order to get agreement in the present WTO round. Some of these countries have a strong ecological component in their arguments saying that the current CAP does not encourage ecologically responsible methods of production.

While some of the supporters of this view would like the cost of agricultural subsidies to be lower, others simply want to channel support into more 'green box' measures and rural development, while maintaining spending on agriculture.

Other countries, and most clearly Italy, have spoken out for the preservation of the CAP The 'swing country' is as usual France, which has indicated that it is in favour of reform, but, as by far the largest recipient of CAP subsidies, is probably unlikely to go nearly as far the group of reformers want. The position of France will not be known until after the French elections in Spring 2002.

The main pressure for reform may, as in the past, come from outside in the form of the current WTO round. Judged today it would seem likely that some reform will follow the publication of the mid-term review by the Commission in mid-2002, though realistically it will be less than the reformers want and perhaps only a minimum to meet the needs of the WTO negotiations.

As far as the financial perspectives are concerned, this almost certainly means that agriculture will continue to decline as a share of EU budget expenditure, in spite of the arrival of ten new member states which are on average more agricultural than the current member states.

As far as the future of the structural funds is concerned, this is of course linked to the outcome of the debate about the future structural funds mechanism, which is in full flow today in the Union. If the rules for allocation of Objective 1 status are not changed after enlargement and the 75% of per capita EU GDP criterion is retained (representing a considerably lower absolute level than in the EU-15), the structural fund resources of the Union would be mainly concentrated in the new member states (this would depend also on whether a transitional exit regime for those regions no longer qualifying for structural funds was agreed or not). If however a regime is agreed which is more supportive of existing beneficiaries, there is unlikely to be a very generous settlement for the new member states in the 2007-2013 financial framework.

In the context of the future of the structural funds, there is strong pressure from the net contributors to the budget to strictly control budgetary expenditure. The Dutch Government has supported a radical option, which would leave the Union only transferring funds to whole countries which have a GDP per capita (in PPS) below 75% of the average for the Union, rather than to regions meeting this criterion.[7] National governments would be responsible for regional policy in Member States, which do not qualify under this condition. This, together with a strict limit of 4% of national GDP for structural fund transfers, would lead to a moderation in the EU budget appropriations for the structural funds. Available funds would be concentrated on the new Member States.

[7] Dutch Government Interdepartmental Working Group, 'Structural policy in the perspective of enlargement of the European Union, The Hague, 2001

This seems to be an improbable result of negotiations between the member states, which are likely to agree on reforms but are unlikely to go so far. The most probable scenario is one where the policy remains regionally based but where the current criteria of 75% remains valid even after the accession of the new member states. There would then be a transitional regime for those regions, which would lose their rights to structural assistance.

This result could lead to the available funds for structural policy in the coming financial framework being little above the current 0.46% of Union GDP, in spite of enlargement.

Other Union policy areas are expanding rapidly and will almost certainly take more room in the budget in the period after 2006 than they do at present. This is true of the Common Foreign and Security Policy and its accompanying foreign assistance (Western Balkans, Africa, Palestine, Afghanistan), defence and security initiatives, justice and home affairs and other areas.

On the own resources side of the budget, the discipline of the Stability Pact in Monetary Union will continue to force member states to resist higher transfers to the Union budget and therefore to be very reluctant to agree to higher levels of spending. This logic applies of course to net contributors to the budget but also to net beneficiaries. The latter receive more from the budget than they contribute, but final recipients are generally individuals (farmers) or the regions (depending on the government arrangements in each member state). Structural funds spending is also governed by the principle of additionality, which means that it implies additional spending (including national cofinancing) above that which the government would normally have made. It is therefore the gross contribution, to be met from the central government budget, which is important for the member states in the context of Monetary Union.

The new Member States are therefore faced with a Union financial framework for 2007-2013, which may be declining in real terms. While on balance resources will have been shifted towards these countries (structural funds), the overall net level of spending in the new Member States is likely to be well below what was expected just a few years ago.

## 5. The impact of the Commission proposals on the financial position of the candidate countries

The proposals which the Commission has made, together with the rules which apply to the Union's financing programmes, will clearly have both longer-term structural implications as well as short-term financial ones.

Longer term implications include a lower-than-expected level of EU support for agriculture and infra-structure development, including transport and environmental infrastructure. Support is likely to be lower for the poorer new member states than for the richer ones.

The infra-structure need of many of the new member states is greater than that of the current ‘Cohesion Member States’. This is true of the whole range of infra-structure but especially for roads, railways and environmental infrastructure. While lower than expected receipts from the Union is unlikely to be important in the short term, as the project pipeline builds up it will force new member states to look for commercial loans to finance rapid infra-structure improvement. For the new member states trying to close the gap between themselves and the old EU member states, this will simply make the investment process more expensive and make it even more important to aim for high domestic savings rates in their macroeconomic policy.

The financial problem in the short-term however will be acute. The pressure on the state budget in most of the new member states is significant because of the requirements of the transition. As they prepare for membership of monetary union, they will also be trying to meet the Maastricht criteria. But in the first two years of membership, the situation is likely to become difficult because of their overall net position in the Union budget, because of the requirements of cofinancing but also because of the predictable delays in the receipt of funds from the Union.

For finance ministers in the new member states, calculating annual budgetary totals is insufficient. They must be able to finance the needs of the country on a day-to day basis. Gaps in funding lead to the need to raise additional funds from the markets at some cost to the budget. When the first year of membership of these countries is considered, the risk of short-term financial instability appears to be considerable.

The key elements of this calculation are as follows:

- If the new member states have to pay their full own resources contributions to the Union budget from the first day of accession, this will involve a monthly payment through 2004 totaling over 1% of GDP for the year
- Direct income payments to farmers will have to be made from the budget in the second half of 2004 but the payments from Brussels will not be made until Spring 2005 (hence the absence of payments appropriations in 2004 in the EU budget)
- There will be a delay (perhaps of around 2 months) in the receipt of other agricultural payments for market measures
- There will also be delays in financing the structural funds and the Cohesion Fund though these are fairly predictable. Each country will receive an advance of 7% of its national structural funds programme and there is advance funding of Cohesion projects of 20% of their costs.
- Cofinancing will have to be found from the national budgets for the structural funds, the Cohesion Fund and the rural development. This will amount to around 20% of the programme value financed (Cohesion fund – minimum 15%; Objective 1 regions in Cohesion countries – minimum 20%; rural development (FEOGA Guarantee and Guidance) minimum 20%). This could amount to EUR 1.5 billion in 2004 and over EUR 2 billion/year in 2005-2006.

On the receipts side (expenditure side of the EU budget), the new Member States will receive payments with some delay as mentioned above, but the real problem will be that absorption of the funds will prove very difficult and hence lower amounts of assistance will be received in the first year than generally expected. This has been the experience of the current member states as well. Many of them are still unable to absorb all the funds available to them in the early part of their structural funds programmes. In the first year of the current programmes (2000-2006) absorption ranged from zero in Greece to 7% in Portugal.

The financial implications of accession-related adjustment in the first years after accession will be severe (environment and social policy acquis and internal market regulation for instance). These increased costs will fall on both the private and the public sectors, part of them being passed on to the consumer. Obviously only part of this expenditure will be covered by transfers from the EU.

As a result of these elements, budgetary expenditure could easily rise by as much as 10% or more in the first year of membership as a result of accession. Such a sudden change in the expenditure side of the budget will be very difficult to finance from domestic resources. **To ease this situation, the Union should consider a funding facility, similar to balance-of-payments lending, to cover the first period of accession.**

## 6. A suggestion for a negotiating position of the candidate countries.

The negotiating position of the candidate countries is very difficult. The Union knows that the candidates desperately need accession to the Union. It has seen from recent turbulence in the Visegrad group of countries that there is little chance of the candidates agreeing on any common strategy; indeed it knows that it can play one country off against another. It can also point to many weaknesses in the institutional preparation for accession in the candidate countries, not least to the low level of absorption of existing funds. Basically the Union can make a ‘take-it-or-leave-it’ offer.

But the situation is not quite that simple. The reputation and credibility of the Union is at stake in these negotiations. If the Union does not enlarge in the next few years, this will be seen as a major setback. Even a delay of a year from the announced timetable will affect its credibility.

On the other hand, most of the governments of the candidate countries have to win referenda as part of the ratification process. The electorate is in general less aware of the necessity of EU membership than governments and therefore has to be persuaded to vote for accession. The decision of the voters will be taken more on the fairness and justice of the offer than on its financial volume. It is a different class of membership which is feared in the candidate countries, rather than relatively low levels of finance. This message has not been understood in Brussels sufficiently well.

It must always be born in mind that these negotiations affect the achievement of several objectives of Government policy:

- the management of the macro-economy
- the restructuring of agriculture and the development of a sustainable and prosperous rural environment
- the development of a transport and environmental infra-structure which is necessary for a modern European state
- winning the referendum on EU accession

The first three objectives must be achieved because they are conditions for future prosperity.

The last objective is however the ultimate veto. If a referendum is held and lost then accession to the EU will be postponed for several years with all the negative economic and political results this will entail.

Completing the accession negotiations and winning the referendum therefore become the main short-term intermediate objective for the Government. Whatever compromises are made to achieve these goals however must not lead policy to fundamentally deviate from the longer term objective of building a modern, prosperous European state, with full participation in the Union.

*The longer term objectives*

Transfers from the EU are important to provide resources for the development of the economy at a faster rate than would otherwise be possible. However the transfer of resources should not compromise other policy objectives.

The management of the macro-economy to produce growth and stability requires in itself a careful management of transfers (avoiding crowding out private investment).

The transfer of a major part of the EU support in the form of direct income subsidies would not contribute to the longer term strategic objectives of government – namely the acceleration of investment expenditures to stimulate longer-term growth (see above). Direct income subsidies will probably flow into private consumption and perhaps increase the external deficit.

As far as the objective of creating in the longer-term an efficient and productive agricultural sector in a prosperous rural economy is concerned, massive direct income subsidies can also not be the right instrument. They will slow down the restructuring that is necessary in the countryside, reduce the uptake on retraining or retirement schemes and create false hopes amongst the farming population.

However there is a question about the desired rate of restructuring, which was mentioned above. Very rapid restructuring in farming is not necessarily desirable because of the effects it would have on unemployment and social discontent. A certain level of direct income support for farmers is therefore compatible with longer term structural aims of policy.

Transfers from the EU are however very necessary for rural development, because employment creation in the countryside is vital for the process of agricultural restructuring.

As to the objective of bringing infra-structure to the level necessary for a modern industrialised nation in Europe is concerned, there is no doubt that this must be a priority and funds transfer from the EU should be maximized for this purpose. Again there is an absorption problem which must be tackled.

*The negotiating stance on direct income subsidies*

The negotiations on reference levels are very important because they risk freezing agriculture into a production pattern with little possibility of expansion, as explained above. Great attention must be paid to achieving a solution which allows the reasonable development of agriculture in the new Member States.

It is however the question of direct income subsidies which will dominate the public debate.

In order to win the referendum, it may be necessary to achieve a somewhat higher level of direct income subsidy in the period up to 2006. This would be detrimental to longer-term development of the economy if made permanent, but losing the referendum would be even more so. Assuming that the Union will agree to reform the CAP and make these income subsidies degressive, this temporary increase above the levels suggested by the Commission could be accepted and might make restructuring more acceptable.

Is this possible? The constraints are as follows:

- any solution must stay within the Berlin Financial Framework (otherwise unanimity from the EU-15 will be required and will not be obtained; the Parliament will also have to decide).
- the result must be positively appreciated by the public and especially the farmers
- support of the EU-15 is obviously essential
- the solution should not negatively affect the long-term development strategy of the Government.

Room within the Berlin Framework can be found to raise direct income subsidies in the first three years of membership to say 35%, 45% and 50% of the levels paid in the EU-15. This would mean that they were paid at roughly 50% above the level proposed by the Commission.

This could be done by exploiting the fact that the full level of commitment appropriations has not been used by the Commission, by transferring some funds from the structural funds to agriculture, or from rural development to direct payments and by exploiting the fact that there is a large difference between the planned payments appropriations and those appearing in the Berlin Financial Framework.

*a. exploiting the full level of commitments in the Berlin financial framework*

A margin exists in the commitment appropriations in the latest Commission document and those in the Berlin financial framework, which is equal roughly to the proposed budgetary compensation payments (roughly 800 million EURO per year). This could be used for agricultural payments instead. This would mean:

- there would be no reserve for compensation payments – but these would only be paid if the candidate country had a net transfer of less than that in the year before accession. So in fact the use of the money for direct income payments would ensure that it is absorbed rather than perhaps not being used.
- this could not be seen as an increase above what the Commission has proposed because it is considered as ‘available for compensation payments’
- there would however be a potential problem in year 1 of accession when direct income subsidies would be advanced by the candidate country Government and, with no compensation payments available, there might be an overall net contribution (but this problem could be tackled on the own resources side).

*b. transferring commitment appropriations in the Berlin financial framework.*

The Commission demonstrates in its own papers that it thinks that such a transfer is possible without opening the Berlin financial framework.

It is highly unlikely that all the commitment appropriations for rural development or structural funds in the Commission proposal can be absorbed in the period 2004-2006. A small part of these resources could then be transferred to direct income subsidies. As direct income subsidies are committed and paid in the same year this would lead to an overall increase in absorption after the first year.

However in the long term of course it is transfers from the structural funds (including the Cohesion Fund) and for rural development which the candidate countries need to maximize, and so care should be taken to make sure that the level of structural funds commitments for the period after 2006 is not affected by this shift of resources in the pre-2007 period.

*c. the question of payments appropriations*

The question is whether payments appropriations are available to meet these commitments.

The answer technically is a clear yes. The Commission paper remains well below the Berlin FF for payments – overall 6.5 billion EURO less from 2004-2006. But of course for the member states it is payments which are important. Adding non-differentiated appropriations will not be appreciated by them because they are expecting far lower payments to arise than commitments made.

As a result of this flexibility, additional direct income subsidies could be paid to farmers in the period 2004-2006. To raise payments from 25% to 35% in the first year would require an additional 470 million EURO (payments in 2005), from 30% to 45% in the second year an extra 700 million EURO (paid in 2006).

This amount could most simply be obtained by using the margin for budgetary compensations.

If such a change was to appear towards the end of the negotiations, it might have a beneficial impact on public opinion. As mentioned above, the EU is likely to decide on degressivity of direct income subsidies after 2006, the impact of a somewhat higher level of direct income subsidies on long-term macroeconomic stability and restructuring of agriculture would not be that severe.

*d. What obstacles might there be to such a perspective?*

1. as mentioned the EU-15 would not appreciate higher payments appropriations. However these would not breach the Berlin financial framework and there are limits to the unfair treatment of the new member states (see recent remarks by Mr. Stoiber).
2. some candidate countries would probably not be in favour of transferring commitments from the structural funds, but they might be in favour of using the margin for compensation payments, if transition periods are agreed on own-resources contributions.

*Maximising absorption of rural development resources*

While it is rural development which is important rather than direct income subsidies, it is true that there is a problem of absorption with the former, which does not exist with the latter.

It will be important therefore:

- to try to negotiate higher levels of funds for rural development in the future, but this will be part of the negotiations on the next financial framework
- to find projects and programmes which allow more rapid absorption.

In the context of the latter point, a careful setting of priorities can obtain results. Higher levels of absorption could be achieved:

- by encouraging many small local projects which do not need complex planning procedures and government procurement – e.g. small local infra-structure projects, farm improvement schemes and grants for small projects favouring employment
- by using resources to increase the availability of loan capital in rural areas – targeted loan schemes, micro-financing etc.

These schemes should be prepared before accession and implemented from the first day of membership.

*Reducing contributions to own resources*

As far as contributions to own resources are concerned, the candidate countries have a clear case for a transition period on contributions matching the assumed transition period in receipts. There are also precedents for such a solution.

To the candidate country of course a reduction in contributions is not 'real money' but the strain on the State budget in the first years of membership will be enormous. Any reduction in contributions will therefore be important.

However a reduction in contributions from the new member states is 'real money' as far as the EU's current members are concerned, because it represents a reduction on the revenue side of the budget but no reduction on the expenditure side. For this reason the tough stance of the Commission is likely to find support amongst the existing member states.

The Union could also of course guarantee the new Member States that they will not be worse off in the first year of membership than their net position in 2003, as proposed by the Commission. This could be guaranteed by a development of the 'compensation payment' proposed by the Commission. Unused payments commitments would then be used for compensating the new member states. This system would however have the disadvantage of rewarding slow absorption of structural and other funds.

The advantage to the new member states of a transition period on contributions to own resources is that it is predictable and can be applied on a monthly basis from the date of accession. Only a relatively small unknown factor would need to be calculated at the end of the year, though this does give technical problems to the budgetary authority. Increased compensation payments on the expenditure side of the EU budget would however by their nature be calculated ex post and be paid in the following year. This would not help with the financial position in the first months of accession.

**In summary then, the strategy of the candidate countries needs to have the following objectives:**

- To limit any negotiation to the financial framework 2000-2006 and not to make any agreement beyond that date
- To negotiate a transition period for the payment of full contributions to own resources of the Union
- To negotiate somewhat higher reference levels for significant agricultural products.
- To increase somewhat the level of payments of direct income subsidies in the short-term but not to a point, which would damage the long-term policy objectives of the governments.
- To negotiate an EU funding facility to cover short-term financing problems in the first years of accession
- To concentrate on ensuring that the institutional structures are in place and the necessary preparations have been made to benefit from the available EU funding from the first day of accession.

At the same time, the internal review of the detailed month-by-month financial implications of accession must be carried out by Finance Ministries. This should include a thorough costing of the agreements already made in the context of the other chapters of the negotiations.

## 7. Conclusion

The proposals of the Commission, as presented in its January 2002 issues papers, should be unacceptable for the candidate countries. However the financial margin of manoeuvre for EU finance ministers in an election year and during an economic slowdown and with an unreformed labour market and social policy is narrow. The candidate countries should concentrate on a few priorities of negotiation and on preparing for high absorption rates of agricultural and structural funds.

Above all the candidate countries should avoid agreeing anything which affects the next financial framework, 2007-2013. This would both be financially damaging and politically dangerous.

**ANNEX:**

Commission 'proposal'

**Financial Framework for Enlargement**
**2004 – 2006**

(€ m, 1999 prices)

***Scenario: Accession of 10 new Member States in 2004***

| | 2004 | 2005 | 2006 |
|---|---|---|---|
| **Commitment appropriations** | | | |
| Agriculture | 2048 | 3596 | 3933 |
| Structural operations | 7067 | 8150 | 10350 |
| Internal Policies | 1176 | 1096 | 1071 |
| Administration | 503 | 558 | 612 |
| Total commitment appropriations | **10794** | **13400** | **15966** |
| *Total commitment appropriations (Berlin 1999 scenario)* | *11610* | *14200* | *16780* |
| | | | |
| **Payment appropriations** (Enlargement) | **5686** | **10493** | **11840** |
| *Payment appropriations ( Berlin 1999 scenario)* | *8890* | *11440* | *14220* |
| PM Budgetary compensation payments | **…** | **…** | **…** |

Source: European Commission, January 2002

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